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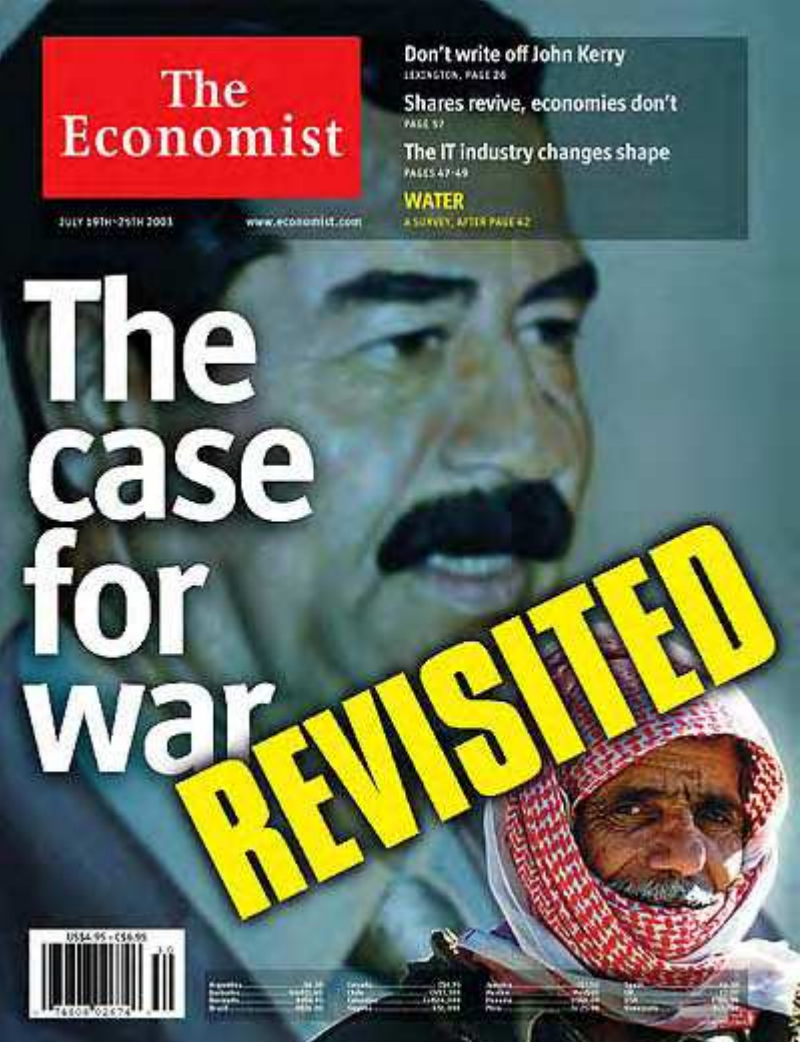

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Politics this week

Jul 17th 2003
From The Economist print edition

Governing Iraq

A 25-member **Iraqi Governing Council,** appointed by the American-led coalition, is to have considerable executive powers, though subject to the coalition's veto. Composed mainly of Iraqis who lived outside Saddam Hussein's control, it nonetheless broadly represents the country's religious and ethnic balance. With American casualties rising (33 combat deaths since the end of the war), there were preliminary moves towards giving the Iraqi police more authority. General John Abizaid, the American commander in Iraq, said America was facing a classic guerrilla war.

See article: Iraq's political devolution

Despite a “warm and constructive” meeting, Tony Blair rejected **Ariel Sharon's** request that Britain should cease dealing with Yasser Arafat, the Palestinians' elected leader. Meanwhile Mr Arafat and his prime minister, Mahmoud Abbas, settled their differences and Mr Abbas withdrew his threat to resign. America gave $20m to the Palestinian Authority, its first direct contribution.

AFP

A Palestinian research group released an opinion poll which showed that, though 95% of **Palestinian refugees** wished to retain the moral right to return to Israel, only 10% would actually want to do so.

See article: The Middle East “road map”

A coup took place in **São Tomé e Príncipe**, possibly in anticipation of the discovery of vast oil deposits around the small African islands. The coup leaders said they had formed a “junta of national salvation” in response to the country's “decline”.

See article: São Tomé's bloodless coup

Burundi's ceasefire broke down, as rebels shelled the capital, Bujumbura, and fought fierce street battles with the army. At least 170 people were killed, and thousands fled their homes.

See article: Burundi's broken ceasefire

In **South Africa**, a government report was leaked which argued that the country could save 1.7m lives by 2010 by distributing **anti-retroviral drugs**. AIDS activists accused the government of suppressing the report, which was completed in April, because of President Thabo Mbeki's doubts about the usefulness of such drugs.

See article: AIDS in South Africa

Iran admitted that a Canadian journalist, Zahra Kazemi, had been beaten to death after her arrest in Tehran.

The pact cracked

France's president, Jacques Chirac, called for a loosening of the **stability and growth pact** rules, whereby countries who share Europe's single currency, the euro, are meant to keep their public deficits

to less than 3% of GDP. Germany's chancellor, Gerhard Schröder, called for more flexibility in interpreting the rules. Most of Europe's smaller governments, some of which have struggled to keep within the limit, loudly disagreed.

See article: France versus the EU's budget rules

EPA

After the recent arrest on fraud charges of Platon Lebedev, the second-biggest shareholder in Yukos, **Russia's** biggest oil company, the tax police raided the company's headquarters in Moscow.

See article: Michael Khordokovsky, a troubled Russian oligarch

The parliament of the internationally recognised state of **Cyprus**—in fact, the island's Greek-run southern bit—voted unanimously to join the European Union.

The **European Commission** suggested a plan to prevent the EU's citizens from receiving unsolicited junk mail ("spam") by e-mail. The Commission also launched an inquiry into alleged fraud by its own staff, particularly in Eurostat, its statistical arm.

Don't like a hurricane

AFP

Hurricane Claudette, the first of the Atlantic season, hit the Texas shoreline close to Galveston. Although it was rated only a category-1 hurricane, sustained winds of around 80mph (130kph) resulted in at least two deaths.

Ari Fleischer gave his 300th, and final, news briefing as the White House's press secretary. His replacement, Scott McClellan, who is unlikely to be any more loquacious, served with President George Bush when he was governor of Texas.

The campaign to oust **Gray Davis** as governor of California claimed it had collected 1.6m signatures. Proponents and opponents filed various lawsuits designed either to speed up or slow down the recall process.

See article: Gray Davis, and his state, in trouble

The House of Representatives voted to maintain a policy of withholding funds from the **United Nations Population Fund**. Republicans accuse the fund of promoting abortion abroad.

Territorial dispute

Hong Kong's political troubles worsened with the resignations of Regina Ip, the security secretary, and Antony Leung, the financial secretary. Their departures followed public anger over the territorial government's inability to revive the economy and its handling of an anti-subversion bill.

See article: Hong Kong's political crisis

Australia prepared to lead a 2,000-strong military force to the **Solomon Islands** to help to bring peace to warring ethnic factions.

After claims by **North Korea** that it had reprocessed spent fuel-rods and had enough plutonium to make more nuclear bombs, the United States said it would continue to work with China, Japan and South Korea to try to persuade the North to abandon its nuclear ambitions. With tensions high ahead of the 50th anniversary of the armistice that ended the Korean war, South and North Korean troops exchanged machinegun fire at the border.

See article: Blame game

Yang Bin, once described as **China's** second-richest man, was sentenced to 18 years in jail for fraud. Mr Yang claimed to have made a fortune from selling flowers, but the prosecution said it came from illegal property development.

Backtracking in Brazil

Brazil's government zig-zagged on pension reform: facing pressure from judges and a strike by civil servants, it offered to dilute the reform bill, but then backtracked when cash-strapped state governors protested.

See article: A test of political skill in Brazil

Colombia's government announced that it would start peace talks with a group of rightist paramilitary gunmen.

See article: Reforming Colombia's politics

Five policemen and two civilians were killed in a clash with Sendero Luminoso (Shining Path) guerrillas in **Peru**, fuelling fears that the Maoist terrorist group is reviving.

See article: A dormant guerrilla group stirs in Peru

By four votes to three, **Guatemala's** Constitutional Court ruled that General Efraín Ríos Montt, a former dictator, could stand for president in a December election. In doing so, the court appeared to violate the constitution.

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Business this week

Jul 17th 2003
From The Economist print edition

Prince succeeds

Sandy Weill, often touted as the king of Wall Street, at last anointed his successor as chief executive of **Citigroup**, the world's biggest financial-services firm. Charles Prince, a lawyer who runs the company's investment-banking businesses, will take over by 2004. Mr Weill will remain as chairman until 2006. Citigroup also said it would pay $3 billion for the credit-card business of Sears Roebuck, a big American retailer.

See article: A big week for Citigroup

America's big banks are doing better than expected. **Citigroup** reported that profits in the second quarter had risen by 12% over a year ago, to $4.3 billion. **Bank of America**, America's third-largest, enjoyed an increase of 23% to $2.7 billion.

Merrill Lynch raked in the profits from a booming bond market. Second-quarter profits at the investment bank rose by 61% over a year ago, to just over $1 billion. **J.P. Morgan Chase's** second-quarter profits also shot up, by 78% to $1.83 billion.

Bad news for **Morgan Stanley**. A judge gave the go-ahead to a class-action suit by investors who claim they were duped into overpaying for an investment fund. Eliot Spitzer, New York's attorney-general, and the Securities and Exchange Commission are also investigating how the bank sells mutual funds.

Satellites in a state

America's **Loral Space and Communications** suffered a loss in space. The embattled satellite maker and operator filed for Chapter 11 bankruptcy protection and sold six of its satellites to a rival, Intelsat. The industry has been plagued by overcapacity ever since the telecoms bubble burst.

Mirant, a big American energy company, filed for Chapter 11 bankruptcy, with debts of $11.4 billion.

Discordiant

The battle for **Cordiant** became more confused. **Publicis**, a French rival, rejected a joint approach with Active Value, an investment fund that owns 29% of the British ad firm. The role of **Nahed Ojjeh**, a rich chess promoter who has amassed a 10% stake, remained a mystery. **WPP**, a big British rival that has offered £10m ($16m) for Cordiant and owns its hefty debts, has now de-listed the company's shares to prevent further stake-building.

See article: Problems for WPP's takeover bid

PeopleSoft's hopes of fending off **Oracle's** bid improved a little. The software firm's $1.75 billion bid for a rival, J.D. Edwards, was approved by American antitrust authorities. Oracle pledged to win one or, if need be, both firms.

British American Tobacco won the auction for Ente Tabacchi Italiano, the state-owned Italian tobacco monopoly. BAT paid *euro*2.3 billion ($2.6 billion) for the company, a price most analysts considered on the high side.

Directors' choice

William Donaldson, the new chairman of the **Securities and Exchange Commission**, swung into action, endorsing proposals that would raise the voice of America's shareholders. At present, it is hard for investors to propose candidates for election to company boards; Mr Donaldson hopes to make this easier, and to help shareholders force votes on policy changes.

Britain's **Financial Services Authority** appointed an insider, John Tiner, as its new chief executive, to the relief of many in the City of London. The recent appointment of an outsider, Callum McCarthy, Britain's energy regulator, as FSA chairman was greeted with less enthusiasm by the City.

Chips with everything

Intel, the world's biggest chipmaker, said that second-quarter profits had risen to $896 million, almost twice as much as a year ago. But **ASML**, a Dutch chipmaker, reported a loss of *euro*63.5m ($71m), compared with a small profit a year ago. And **Samsung**, a South Korean giant, said that profits were down by 41% to 1.1 trillion won ($910m), partly because of falling chip sales.

Further evidence of the internet's return to favour was provided by **Yahoo!**. The world's leading portal agreed to pay $1.6 billion for **Overture**, a company that offers advertising linked to specific search terms on the internet.

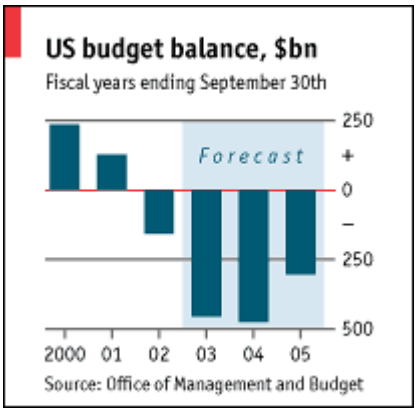
See article: Searching for relevance

Over-exuberant?

Alan Greenspan struck an upbeat note in his half-yearly report to Congress. The Fed chairman said that America's economy "could very well be embarking on a period of extended growth" and hinted that interest rates would stay low. He also chided American firms for a "pervasive sense of caution" over investment.

America's Office of Management and Budget estimated that the **federal budget deficit** would now reach $455 billion for the current fiscal year, and $475 billion next year. The revised figure for the current year is over 4.2% of GDP.

See article: Problems in the government's finances



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The war in Iraq

The case for war—revisited

Jul 17th 2003
From The Economist print edition

Why we still think, on present information and trends, that the war was justified

Get article background

Reuters

THERE are many good arguments against war, but high among them is its ability to bring surprises, many of them unpleasant. The second Iraq war was no exception to that, though it may have been unusual in bringing surprises both to those who were in favour of it and to those against.

Many advocates of the war were surprised by how rapidly it was won, by how few casualties were caused among both soldiers and civilians, by the fact that no biological or chemical weapons were used by Saddam Hussein and, most controversially, by the fact that no stockpiles of such weapons have yet been found in Iraq. Advocates were also surprised and dismayed, though, to find that America appeared to have no coherent plan for what to do in Iraq once the war was won. Many of those who were against the war were also taken by surprise, however, by its speed, by the lack of a deadly street battle for Baghdad, of a flood of refugees or an epidemic of cholera, and by the lack of uprisings or instability in other Arab countries and of terrorist attacks during the war. Most were further surprised, though presumably not dismayed, by the serious commitment to Arab-Israeli peace shown by President George Bush soon after the invasion.

More of those surprises have been pleasant than unpleasant, though it is too soon to make a definitive reckoning of that sort. In Iraq, many civilians feel insecure and poorly served with such basics as electricity and clean water, and American soldiers are being killed almost daily. The ceasefire in Palestine is fragile and the talk of peace negotiations and roadmaps always at risk of collapse. Nevertheless, three months after the war was won, one question demands to be answered, mainly because no weapons of mass destruction have yet been found: was the war really justified?

The threat posed by Saddam

The Economist certainly said it was. We did so most strongly and clearly in a survey ("Present at the creation", June 29th 2002) on America's world role; and in leaders on August 3rd that year ("The case for war"), February 22nd 2003 ("Why war would be justified") and March 15th 2003 ("Saddam's last victory").

People who favoured war on the ground that Saddam Hussein posed a threat by virtue of his weapons must, if they are honest, admit to feeling undermined and even slightly unnerved by the fact that none have yet been found. They could well still be found: Iraq is a big country, chemical and biological weapons are often small, and Mr Hussein was shown during the 1990s to be a past master at concealment. Three months is not long for a search, especially amid the chaos and other tasks of the immediate post-war period. Still, the fact that no stocks have been found does at least imply that weapons were not widely deployed for use during the war, as otherwise some would surely have been captured during the allies' rapid advance. The British government's much-derided claim that weapons were capable of being launched within 45 minutes therefore does look to have been wrong.

However, the question of whether the war was, in retrospect, justified does not rest on that claim, or on the issue of whether Mr Bush or Tony Blair may at times have gone too far in turning possibilities raised

by their spies into apparent certainties. Rather, the justification for the war is best addressed by dividing it into three questions: 1) Were there good grounds to threaten Mr Hussein with an imminent military attack if he did not comply with United Nations resolutions? 2) When he did not comply, were there good grounds for carrying out that threat? 3) After the military victory, have the allies acted in such a way as to make things better both in Iraq and in the region as a whole?

Mr Hussein himself provided the answer to the first question. He had signed an agreement in 1991, after the first Iraq war, under which he promised to get rid of his nuclear, chemical and biological weapons and programmes, to scrap long-range ballistic missiles, and to stop brutalising his people, among other things, all within a year. He did not comply, and UN weapons inspectors established that he had concealed his weapons, thanks to tip-offs from defectors. For example, having at first denied that he had ever produced a deadly nerve agent called VX, he then responded to a discovery by claiming to have made only 200 litres, but then the UN inspectors showed that at least 3,900 litres had been made. Having established that he could not be trusted, inspectors were barred from Iraq after withdrawing in 1998. Given that, by 2002, he had flouted 16 binding UN resolutions, how best to persuade him to allow inspectors to return? By making a credible threat that the measure promised by such resolutions, the use of force, would be carried out if he didn't. That required the stationing of troops on his border and the passing of a further UN resolution in November stating what he had to do to comply.

None of that has been called into doubt by the lack of discoveries since the war. Mr Hussein had a clear record of developing these weapons, using them and concealing them. There can also be no doubt both that he was a brutal, ruthless dictator who murdered hundreds of thousands of his own citizens and that he harboured ambitions to dominate his region: he had fought Iran during the 1980s, had invaded Kuwait in 1990, and threatened Israel, Saudi Arabia and (in 1994) Kuwait again. He was thus plainly a dangerous man, in whose hands such dangerous weapons could pose a real threat, both to regional peace and, through the power that dominance of the world's oil reserves would bring, to the whole world.

The case for impatience

What, then, of the second question? Was it right to carry out the threat, making the war both punitive and pre-emptive? Of one thing there can be no doubt: he did not comply with November's resolution. The weapons inspectors appointed by the UN said that he did not, either in his formal (vast) declaration in December or in the inspections process itself. For a man with a proven record of concealment, to choose not to comply, even as American and British troops were massing on his border, was remarkable. There was also then, however, a debate: might he be persuaded to comply by further UN inspections, during which (for instance) he might at last agree to allow Iraqi scientists to be flown out of the country for questioning, with their families? Those who opposed war in March, but had voted for the November resolution (including France), thought he could be, since he seemed to have become more co-operative. Those in favour of carrying out the threat, including *The Economist*, thought that to wait was too risky. He had successfully wriggled away in the past when offered the chance of delay, and could well do so again.

Reasonable people could disagree about that decision, and about whether it might have been better first to get a unanimous vote on a new Security Council resolution. But neither the non-discovery of weapons nor the recent evidence of exaggeration by the British and American governments of elements of their claims alters the argument for or against permitting further delay. Mr Hussein was believed, on good grounds, to be both dangerous and a liar. On previous occasions the UN process had fallen apart after delays led to divisions. The attempt to use containment, sanctions and inspections had lasted 12 years: hardly a sign of impatience. The prospect that he could emerge from it able, after a year or two, say, to revamp his weapons programmes and threaten his region was real. Both at the time, and in retrospect, the decision to go to war rather than to wait was justified.

What then, it is reasonable to ask, might change *The Economist*'s mind? If Messrs Bush and Blair are shown not just to have exaggerated but actually to have lied, knowingly putting false information before their voters, it would be a huge scandal and would destroy their governments' credibility for future interventions overseas. But to make the Iraq war look unjustified in retrospect, such a scandal would have to amount to clear evidence that it had not, in fact, been reasonable to believe that Mr Hussein was a dangerous liar and concealer—which would require the distortions or deceits to have been astonishingly widespread and conducted over a long period of time. Given that spying agencies currently look incompetent rather than capable of such a broad, effective campaign, this looks unlikely. But there is another mind-changing possibility. It lies in the answer to the third question: After the military victory, have the allies acted in such a way as to make things better both in Iraq and in the region as a whole? If

they hadn't, or didn't in the future, that could indeed make us decide that the war had not, after all, been justified.

They have to be serious

Ultimately, even if the grounds for going to war in March 2003 were strong, the case for it also depended on the notion that America and its allies were determined to make the country and its troubled region more peaceful, more prosperous and less threatening in the future than might have been the case had Mr Hussein been left in place. Many of the opponents of the war thought they were not: that Iraq might be left to collapse in civil war or else might be repressed and exploited as an American colony; that countless fresh grievances would be created, causing more terrorism; and that there would be no serious American effort to bring about peace between Israel and the Palestinians.

It is, of course, far too soon to come to a judgment about this. What can be said, though, is that so far the picture is mixed but on balance moderately encouraging. President Bush has certainly begun a serious effort to persuade Israel and Palestine to make peace, and that process has inched edgily forwards. The future question will be whether he maintains that effort in the face of inevitable setbacks, and of the fact that both Yasser Arafat, still the Palestinian figurehead, and Ariel Sharon, the Israeli prime minister, are reluctant either to compromise or to help build trust. There is also the distraction of the 2004 presidential election in America. The grounds for cautious optimism are that President Bush really cannot afford to shrink back now that he has made his commitment; and that the opportunity for change provided by the victory in Iraq will not last forever. That must be the hope, and must be what Mr Bush's allies should urge.

In Iraq itself the Americans made an appallingly bad start. Their reasons for having had no post-war plan are almost as incomprehensible as Saddam's reasons for having neither complied with the UN resolution nor deployed any banned weapons. They have also failed, so far, to beat back or deter the guerrilla tactics being used against them. There are, though, some encouraging signs too. Chief among them is the establishment during the past week of the new 25-member Iraqi Governing Council, the first big step the Americans have taken towards devolving power to Iraqis themselves and towards establishing some sort of representative democracy.

The new council (see article) is far from democratic—its members were picked by Paul Bremer, America's chief administrator, albeit after consultation—but it is fairly representative. It is hardly surprising that it took three months before such a council was set up, given that Iraq has only just emerged from a long and repressive dictatorship. But the delay still sowed doubts about America's intentions. So too has the slowness, in the face of sabotage, to restore electricity supplies. America's predicament is that it must simultaneously prove that it is committed to staying in order to rebuild Iraq as a secure, stable and peaceful country, and that it is preparing to hand over power to democratic institutions and to leave.

Making the council a success will be an important part of that. So too will be the commencement of real work to prepare for elections, first at a local level and later at national level. Alongside that, however, there can be no substitute for the deployment of people and money: more troops, to pacify the areas of Iraq in which guerrilla campaigns are being fostered and to show that America is not going to allow the Baathists to claw their way back; more money, to restore utilities faster and as a further show of commitment, particularly given that oil exports have been much slower to resume than was expected.

But will America really remain committed, especially in the face of daily casualties? Again, the answer is that it cannot afford not to be. Afghanistan has been left, both by America and by other rich countries, in far too vulnerable and disorderly a state. That is tragic and shameful, but if the same were to happen in Iraq the result could be catastrophic: a deadly civil war in which neighbouring countries felt they had no option but to become involved, and a huge stain on America's reputation, not only for justice but also for effectiveness.

In America's history there are too many examples of a short attention span. But there are also bigger examples of the country's ability to pick itself up after initial stumbles and to sustain a long-term commitment: the troops that have sat in danger by North Korea's border with the South for 50 years; the Marshall Plan that boosted Europe's economic recovery a full two years after victory in the second world war. Again, a long-term, costly commitment is going to be needed.

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Liberia

Why Liberia is not Somalia

Jul 17th 2003
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And why America should send its soldiers to restore peace

WHEN George Bush was campaigning for the presidency, he said that he opposed sending American troops on nation-building missions, especially to chaotic places where no American national interest was at stake. Liberia is almost a caricature of such a place. It is of no strategic importance, its annual output is roughly what Americans spend on skiing equipment, and its civil war is both bloody and bizarre: drug-emboldened teenagers in masks and dressing-gowns rape and loot; perhaps 200,000 out of a population of 3m have died. At a time when America's forces are sorely stretched, Liberia is surely the last place a wise president should send them.

Such thoughts doubtless occurred to Mr Bush when he discussed Liberia with Kofi Annan, the UN secretary-general, this week. Mr Annan, who as a West African is particularly worried about the inferno in Liberia, urged Mr Bush to extinguish it. Mr Bush said he would find ways to help a promised Nigerian-led West African peacekeeping force, but had not yet decided whether to deploy American troops. He added that any such deployment would be limited in size and duration.

Fair enough. Those who argue that America has a duty to solve Liberia's problems simply because the country was settled by freed American slaves nearly two centuries ago are wrong. (Does Britain have a duty to solve America's problems?) Nonetheless, there is a moral case for American intervention. Liberia's war is not only a human catastrophe; it is also destabilising much of West Africa. Liberia's president, Charles Taylor, has started or fuelled wars in three neighbouring countries: Sierra Leone, Guinea and Côte d'Ivoire. So long as he remains in power, there is a risk that the region could slide into mayhem. The world hardly needs more failed states.

The last time America sent troops to Africa on a humanitarian mission, it was a disaster. In Somalia in 1993, they failed to impose order, and Bill Clinton pulled them out after 18 were killed. But Liberia is quite unlike Somalia. Somalis, who are almost all Muslims, tended to see the Americans as infidel invaders. Liberians, by contrast, are possibly the most pro-American people on the planet, and are begging the Americans to come and restore calm to their shattered nation.

Less important than Iraq, but easier

A more relevant parallel would be Sierra Leone in 2000, when a few hundred British soldiers stopped a civil war that had killed 200,000 people. America could do the same in Liberia. The capital, Monrovia, where much of the population huddles, is on the coast and easily accessible. American soldiers could secure it in days, and use it as a base from which to pacify the rest of the country. Some of Mr Taylor's gunmen might cause trouble, but America could surely handle them. As the situation stabilised, the Americans could gradually hand over to a UN force, as the British have been doing in Sierra Leone.

The alternative is merely to provide logistical help to the Nigerians. This would be better than nothing, but it would stir awkward memories. The last time Nigerian peacekeepers came to Liberia, in the mid-1990s, they showed an alarming tendency towards organised crime. The West African force they led, ECOMOG, was known to its supposed beneficiaries as “Every Car Or Moveable Object Gone”. Granted, Nigeria was then a military dictatorship; now it is a born-again democracy. Still, an American-led force would be much more likely to bring peace to Liberia, and so to West Africa.

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Energy policy

Fact and fission

Jul 17th 2003
From The Economist print edition

Nuclear energy does not merit more investment

NO NUCLEAR or new nuclear? It is a big question for energy policy these days. In Britain, where managerial incompetence and negligence over safety have fuelled a crisis of confidence in two big nuclear operators, an anti-nuclear lobby is calling for all nuclear plants to be shut. In Japan, similar problems have led to a temporary shutdown of most nuclear plants that could trigger a wave of blackouts this summer (see article). But in China and South Africa, governments have given their blessing to new nuclear plants; and the Bush administration's energy plan also supports the idea.

The case for nuclear today has two main components: energy security and climate change. The first argues against shutting nuclear plants, and for opening new ones, on the ground that getting rid of nuclear would make the rich world even more dependent on imported fossil fuels. The second argues that, unless nuclear plants (which produce no greenhouse gases) are replaced with new ones when they go out of service, more fossil fuels, notably coal, will be burnt, making it impossible for governments to tackle global warming.

On the basis of these two claims, the nuclear lobby is vociferously demanding more government support for new plants. In America, the industry will partially get its way: Congress is shortly to extend the Price-Anderson act, which provides unlimited government insurance for nuclear operators in case of catastrophic accidents. In Britain, the government has stopped short of proposing new plants, but it has bailed out British Energy rather than letting it go bust. France continues to subsidise its nuclear industry; several other European governments are thinking of building new plants.

Should governments be embracing nuclear as a clean energy source of the future? The short answer is no. Arguments based on energy security do not stack up. Even if nuclear power were replaced by fossil fuels, the main substitutes would be coal and natural gas; unlike oil, these are plentiful and not subject to the control of OPEC. The right approach to energy security is through deregulated markets and diversified sources of supply, not via subsidies in the name of “energy independence”. Besides, as today's troubles with Iran and North Korea suggest, encouraging the creation of more fissile material is a poor way to pursue any kind of security.

Let the market decide

The reliance on climate change to save nuclear is also misplaced. Nuclear plants do not have to be replaced with carbon-intensive fuel: if plants are phased out over time, more renewable energy and greater energy efficiency could fill the gap. In any case, the right way to encourage climate-friendly energy is not to subsidise specific alternatives such as nuclear or, as the British government proposed this week, wind power (see article), but to send a technology-neutral signal to the market that greenhouse gases have costly side-effects. And the way to do that is to impose a tax on all carbon emissions. Yet even a heavy carbon tax would not make new nuclear plants economically viable without big public subsidies.

There is thus little case for throwing good public money after bad to build new nuclear plants. But that does not mean it makes sense to shut nuclear plants permanently. The proper response to safety concerns is for regulators to police nuclear operators with renewed vigilance. The many that have strong

and even improving safety records should be rewarded, as regulators in America and elsewhere have done, with extensions on their plants until the end of their useful lives. Those operators that are shown to be unduly lax or reckless should be put out of business.

None of this needs to mean that the lights have to go out across Tokyo. The good news is that Japan, following European and American examples, is liberalising its power industry, which should make it more efficient and more reliable. Why not let the state-owned, but highly safety-conscious, Electricité de France take over Japan's nuclear plants?

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Teenage sex

Steamy, heated and wrong

Jul 17th 2003
From The Economist print edition

Britain's new sex law bans teenage kisses. It shouldn't

Reuters

WEAPONS of mass destruction were blown off Britain's front pages this week by 12-year-old Shevaun Pennington, who decamped for a few days with Toby Studabaker, a 31-year-old American ex-Marine whom she met in an online chatroom. The story hits some of modern Britain's hottest buttons: sex, children and the internet.

For reasons which sociologists struggle to understand, and despite a fall in sexual offences involving children, paedophilia has become a regular, reliable source of newspaper hysteria in Britain in recent years. In response to this outburst of public concern, a new law is now passing through Parliament, making seduction of children over the internet (known as “grooming”) a crime punishable with five years in jail—more if it actually leads to sex. That should encourage grown-ups to think twice before starting steamy online friendships with people of uncertain age and identity, but is an excessive punishment for writing dodgy letters.

More worrying still is the criminalisation of all sexual contact involving children. The existing law already prohibits sexual intercourse or “indecency”, however consensual, with anyone aged under 16. But the new law widens that to include “sexual touching”, which includes fully clothed kisses and cuddles, even among consenting 15-year-olds. They, as the law stands, could face a five-year prison term.

Although an absolute and puritanical approach to juvenile sex may have the virtue of logical consistency, it has the drawback of failing to reflect real life. A third of 16-44-year-old men and a quarter of women say they had full sex before the age of 16. Many will have had their first fumbles behind the bike shed well before that. They may regret it later if they started early, but not because it broke the law.

There are sensible public-policy reasons for encouraging teenagers to engage in sex later rather than sooner, but using the criminal justice system to do it is wrong. It makes the law look an ass; it blurs the important distinction between real child abuse, which is wicked, and teenage canoodling, which is not; it has bad practical consequences, most obviously in discouraging teenagers from seeking advice about contraception and sexually transmitted diseases.

Finnesse

Some Europeans deal with the issue much better. In Finland, for example, sex involving under-16s is illegal, but there is a defence of proximity—“if there is no great difference in the ages or the mental and physical maturity of the persons involved”. Whereas a 22-year-old taking a 14-year-old to bed is probably committing an offence, the same 14-year-old with a school classmate is probably not. That seems commonsensical and workable. The government says that it will advise the Crown Prosecution Service not to pursue children engaged in “harmless consensual sex”. But passing a law which you say you are not going to enforce is a bad idea.

The government is now considering amendments before the bill goes before a parliamentary committee in October. There will be no perfect answer—indeed during the last debate on the bill the home secretary offered champagne to anyone who could come up with a satisfactory law on all this. But an explicit exemption for juvenile sexual behaviour where no abuse is involved is needed. Teenage bedrooms are a

difficult enough area of family life without police involvement.

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Letters

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From Economist.com

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Capitalism's future

SIR – I do not share the optimism you display about the future of capitalism in your survey (June 28th). You suggest that the law, and a reliance on an open and globalised market should suffice to bring it through the current shaky spell. First, the law has failed miserably to protect shareholders in the recent spate of big scandals. Respect for the law diminishes proportionately as the rewards for breaking it grow. Global markets have contributed to this by adding zeros to these potential rewards. Capitalism's life-blood is trust and confidence, and it is hard to see how this can be restored while similar scandals remain eminently possible.

Second, the West (in particular America's businesses and government) displays a woeful lack of finesse in its attempts to persuade those who are unconvinced by capitalism that "conversion" is the way forward. As it turned out, the debate with the old left was won fair and square on an economic platform. The new debate, with those who are prone to blow themselves up for their mysterious cause, is going to be a lot trickier.

Jack Delawney
London

SIR – You ask "how could billions of disconnected selfish interactions ever yield an outcome that is collectively right? Adam Smith answered that question...but those who believe what he said are regarded by many fair-minded people as slightly mad." And with reason. Justifying capitalism on utilitarian grounds can always be attacked as unjust because some people (the productive) must be allowed to remain relatively rich in order to create the greatest good for the greatest number. Most people, including many economists, consider this presumptive evidence of capitalism's guilt. Free-market advocates, such as *The Economist*, then become mere apologists for it as a necessary evil.

In truth, the collective good is only a side benefit of capitalism and a corollary of the following. Capitalism is the only economic system that mirrors constitutional democracy as a political system in guaranteeing justice to the individual by protecting his rights. That a man is entitled to the fruit of his labour is right by natural law; it is not a privilege granted by the state to promote the collective good or some other whim. Only when capitalism is defended as just, not merely optimal, will the world be safe for the system and by extension for constitutional democracy.

Steven Pearson
Oakland, California

SIR – Thanks for the "Radical birthday thoughts" on your 160th anniversary. You display a critical insight not always present in your newspaper's advocacy of economic liberalisation and opposition to unions, workers' benefits and social programmes.

However, your statistics demonstrating a reduction of poverty do not justify your conclusion that more liberalisation is always better. They do show that the trend away from authoritarian command economies is a good thing. But, as you recognise, poverty has been reduced where governments "adopted liberal trade partially, selectively and mostly gradually." I cannot think of any nation that has ever industrialised without some trade protections.

Spencer Segalla

Centereach, New York

SIR – Your chart on world income inequality by Xavier Sala-i-Martin nowhere emphasises that a log-scale of income is used. It is misleading to use it to show a pseudo-normal distribution and claim the existence of a “world middle class”.

Claudio Calcagno
London

SIR – As you say, separating business from politics is, at the very least, tough. But imagine a world where consumers boycotted not only companies that violate labour or environmental standards but also those that eat up taxpayers' money or corrupt politicians with their donations. What a world that would be.

Nikos Tsafos
Piraeus, Greece

SIR – You seem to equate economic and technological progress with civilised progress. If the founder of *The Economist* was alive today, I seriously doubt whether he would repeat his claim that “morality, intelligence and civilisation have been rapidly extending on all hands.” And I am quite sure he would never have stood “four-square...for uninhibited intercourse.”

Hugh Clift
Lesmurdie, Australia

The perils of union

SIR – Charlemagne misses the most obvious reply to the argument of supporters of the EU's draft constitution. They say that it is “political integration or war” (July 5th). The “United States of Europe” is an echo of a well-known political union in North America in which political integration caused, rather than prevented, a major armed conflict.

Andrew McGuinness
Luton, Bedfordshire

He's no Bismarck

SIR – Silvio Berlusconi may be inimitable but his antics before the European Parliament are not unprecedented (“Berlusconi performs”, July 5th). They bear a striking resemblance to the way that Otto von Bismarck conducted himself at the Diet of the German Confederation in the mid-1850s. Bismarck's favourite pastime was to infuriate liberal members of the Diet with dismissive remarks and personal insults. He accused Austrian members of lying, stealing dispatches, gambling and using prostitutes. To a friend he wrote: “No one, not even the most evil-intentioned sceptic of a democrat, would believe what charlatanry and pomposity lie hidden [in the Diet].”

Bismarck was as unloved by the liberals of his time as Mr Berlusconi is unwanted by today's socialists. But that is where similarities end. Bismarck became a statesman; Berlusconi is an entertainer.

Risto Penttila
Oxford

SIR – You say that Silvio Berlusconi is an embarrassment because of his legal problems and not fit to represent Europe. But his new immunity law brings Italy into line with France. Jacques Chirac would be in prison for corruption were it not for his immunity while in office. Looking further back, Helmut Kohl, Valéry Giscard d'Estaing and numerous former Italian leaders went unpunished for illegal activities. Hence, Mr Berlusconi is quite representative of Europe's leaders.

Doug McClelland
Vancouver

A scent of man

SIR – James Bond is no David Beckham, you say ("Real men get waxed", July 5th). Ah, but doesn't Bond's use of Floris grooming products indicate a "metrosexual" inclination? He was partial to Floris 89, available from Floris in London's Jermyn Street, and other upmarket establishments.

Paul Kellogg
New York

SIR – Since straight men have been taking their cues from gays for sometime, I find the word metrosexuality very queer. This is not a phenomenon about the sexuality of cities or the urbanisation of courtship; it is about straight men mimicking their gay counterparts. So why not call a spade a shovel and refer to it as "fauxmosexuality"?

Steve Cooney
Toronto

Blowing bubbles

SIR – The simultaneous existence of bubbles in equities, property and Treasuries (The Buttonwood column, Economist.com, July 8th) isn't inconsistent in light of the Bush administration's fiscal policies. Borrowing hundreds of billions of dollars and dumping most of them into glutted capital markets can only bid up the value of all investments, regardless of how marginal they may be. After all, capital seeks opportunities for profit whether or not such opportunities actually exist.

One could argue that the three bubbles are driven by a fourth, one that's unsustainable fiscally and perhaps politically. I suspect that the reason "Buttonwood has yet to find anyone who thinks that there is a bubble in all three" is that "in bubbles all news is either good or irrelevant," especially when one of the bubbles in question has its origin in electoral politics.

Tom Marney
Lawrenceville, Georgia

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Governing Iraq

The new men, and women, in charge

Jul 17th 2003 | BAGHDAD
From The Economist print edition

AFP

Iraq's appointed Governing Council has to teach itself how to govern, quickly

Get article background

A FRAIL newborn, the Iraqi Governing Council yelled lustily at its first press conference this week. Responding to a BBC question about the council's supposedly “limited” powers, Jalal Talabani, the garrulous head of the Patriotic Union of Kurdistan, grabbed the microphone to denounce a network which “twists” the facts. His fellow council members then pitched fiercely into the Arab satellite stations, accusing them of exaggerating the problems. “They betrayed us,” declared Muhammad Bahr al-Uloom, a Shia cleric. “They're waiting for the return of Saddam [but] there's no way that Saddam can come back. He has gone to the dustbin of history.”

These spontaneous outbursts suggest that the 22 male and three female councillors, most of whom were members of Saddam's opposition-in-exile, are only just beginning to think of themselves as a government. They are unpolished, unpredictable, and as much concerned with burying the old system as defining a new one. Their first decision, read out by Mr al-Uloom at the inauguration ceremony on July 13th, was to cancel all public holidays linked to the Baathist regime, and to declare April 9th, the day that the dictator's statue came down in Baghdad's central square, as a new one. The next day the council established special tribunals to judge members of the old regime.

These decrees have a political purpose that goes beyond the revenge of a triumphant opposition. The image of a Shia Muslim sweeping away the trappings of Baathism on behalf of a new Iraqi authority, packed with the regime's old enemies, is deeply demoralising to Saddam's remaining supporters—and to members of the Sunni elite who still believe that they are the natural rulers of Iraq. Even so, the council, which was described by a spokesman for one of its members as “25 players from different teams brought together on the day of the World Cup”, needs soon to start behaving like a government. It has, after all, got many of the powers of one.

The council has the authority to appoint and dismiss ministers. It will be able to amend the emergency 2003 budget prepared by the ruling American-led body, the Coalition Provisional Authority (CPA), and to draft the budget for 2004. And, probably its most important task, it will supervise the creation of a congress to draft a new Iraqi constitution. The Kurds, who strongly favour a federal solution, believe that the council is pointing their way.

Once a constitution is approved in a referendum, free elections will be held. Then, according to Paul

Bremer, the CPA's chief, “our job, the coalition's job, will be done.” Only “operational security”—the deployment of troops—currently remains outside the council's mandate. The CPA also retains the power to veto the council's rulings. But both Mr Bremer and Adnan Pachachi, a respected council member, say that they do not expect that to happen.

Experts from the bazaar

How the council got such powers is a matter of contention. Mr Bremer, when he took over the CPA in May, cancelled his predecessor's plans for a national assembly to choose an interim government, and declared that he would set up an appointed advisory council instead. The CPA head reportedly believed that the Iraqi opposition was too disorganised to run the country, and that only a strong manager like himself could handle Iraq's problems. However, over the next two months, Mr Bremer's “advisory” council became a “governing” one.

CPA sources now say that it had always envisioned a council with control over ministries and budgets. But council members describe a tense bargaining period during which—helped by pressure from the United Nations and the editorial pages of American newspapers—they won the council its current powers.

Council members may have fought for Iraqi sovereignty, but they were still appointed by the CPA, and will need to win themselves legitimacy as Iraq's representatives. The CPA made sure that the council represents the country's ethnic and sectarian balance. It contains 13 Shias, a community that makes up 60% of Iraq's population but has always been under-represented in government. The other members—five Sunni Arabs, five Kurds, one Assyrian Christian and one Turkmen—were also chosen in rough proportion to Iraq's demographic make-up.

The council has doctors, lawyers, judges, businessmen and (somewhat controversially) one former member of the old regime's diplomatic corps. It contains representatives of most of the main political trends, including six Islamists and a Communist. It has voices that are friendly to the Americans, such as Ahmed Chalabi of the Iraqi National Congress, who delivered a message of thanks to George Bush—and those who are less so, such as Abdelaziz Hakim of the Iranian-backed Supreme Council for Islamic Revolution in Iraq, who declared that the council was the best way to end occupation.

Seated together beneath a map of Iraq (the flag, bearing the words “God is Great” in Saddam's handwriting, was just a touch too Baathist for the occasion), the council members, in the robes of Shia clergymen and the gold-trimmed cloaks of tribal leaders, in Muslim *hijab* headscarves and in lots of business suits, looked like a reasonable cross-section of the country.

One large group of Iraqis, however, are under-represented: those who spent the past decades under Saddam's rule. Of the 25 members, 16 came to Baghdad either from exile or from the Kurdish self-rule areas. The CPA did not really try to find a representative of each major region or tribe, and the most frequently voiced criticism of the council is that it is a collection of outsiders who cannot properly represent the interests of the people.

Selected not elected

Another concern is the response of the followers of a young Shia cleric, Muqtada al-Sadr, who is excluded from the council. Mr Sadr is not taken seriously as a religious authority by most of the senior clergy, but his father was “martyred” by Saddam in 1999, and his followers claim the legacy of the hundreds of thousands (they say millions) of Shias murdered by the previous regime. The movement commands considerable support in the slums of northern Baghdad and in the holy city of Najaf. Mr Sadr himself is implacably hostile to the occupation. A spokesman for the group says a definitive statement will be made at this week's Friday prayers in Najaf.

The council plans to send a three-member delegation to the United Nations on July 22nd, hoping to win recognition as the Iraqi interim authority mentioned by the Security Council's post-war Resolution 1483. Closer to home, Amr Moussa, the secretary-general of the Arab League, said that the council “would have gained much power and credibility” had it been elected. Several Gulf states have been more generous in their praise, welcoming the body's creation. After all, the council has at least one strong point in its favour: it cannot be any less representative of Iraq than its dreadful predecessor was.

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Life under the coalition

Dodge City on the Tigris

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From The Economist print edition

Can the council help to solve Iraqis' main grouse: the lack of security?

Get article background

AP

A BURST of automatic fire rings out over a row of pavement money-changers on west Baghdad's busy Mukhabarat Street. As the traders whip out their pistols and scurry to see what's going on, several Kalashnikov-armed men order the passengers out of a yellow cab. A driver passing by is barely fazed by what appears to be broad-daylight robbery (though turned out to be merely cautionary action by other money-changers). A month ago, he says, he saw three would-be carjackers gunned down by the car owner. Baghdad, 20 years ago a boomtown attracting expatriates from across the Arab world, is now famous for its wild west lawlessness.

Iraq's new Governing Council is inheriting a capital in a mess. There has been some progress in recent weeks. American and Iraqi technicians have managed to restore power in the city from none at all to a spotty 12 hours a day. Schools and police stations have been reopened, food distributed and some salaries have been paid.

But many advances go suddenly into reverse. Long lines at the petrol stations shrank dramatically when the Americans began deploying troops to prevent the capital's more entrepreneurial residents from buying up the day's supply to hawk by the wayside at ten times the price. The troops then withdrew, and the scalpers and the queues returned. Baghdadis fired their guns into the air in joy when the power came on, but were thunderously let down when the system crashed late last month.

The Americans' sanguinity about the situation is greeted cynically. Recently Lieut-General Ricardo Sanchez, the senior commander of American forces in Iraq, said that Baghdad's crime rates were “comparable to a major American city.”“Maybe Dodge City,” sniffed a local businessman, on hearing the comparison.

The army has not supplied figures to back up General Sanchez's claim. It is probably true that the Iraqis make out the incidence of crime to be even greater than it actually is. Nonetheless, women stay at home, and it is a rare Baghdadi who cannot supply an anecdote of a relative or friend carjacked, robbed in their homes, extorted from, or otherwise subjected to violence during the past three months.

Baghdad's problems are reflected elsewhere. Obviously, there are regional variations. Basra, for instance, suffers particularly from a shortage of clean water. Several smaller towns complain less about street crime, and more about the rough treatment meted out by American troops. However, throughout the country, most of the problems can be tracked down to two basic, intertwined causes: the lack of power and the lack of security.

No lights makes it easier for criminal gangs or anti-American resistance fighters to operate. No security means that precious money needed to upgrade existing infrastructure is instead spent on replacing stuff that has been stolen. Insecurity makes civil servants reluctant to go to work, and deeply discourages private investment from outside.

The new council will have considerable difficulties addressing the power complaints. A source at the CPA says that Iraq currently generates around 3,300 megawatts of electricity, compared with 4,400 at the

time of peak demand last summer. He points out that even before the war, Iraqi engineers “held together the system with rubber bands and bandaids.”

The CPA and the Iraqi Electricity Commission are bringing in new equipment to patch up some installations, even as other facilities are stripped away by pillagers. Progress is not always forward. On one of Iraq's two major south-to-centre high voltage lines, 17 towers were down by the end of the war. Thanks to the gangs who topple the towers to smelt the copper cables for sale abroad, the total down is now over 60.

Iraqi electricity officials hope that they can reach pre-war levels of output by the end of this month, though others are not so optimistic. But even that level of power will not satisfy everyone. Saddam Hussein starved the provinces of power to feed Baghdad. Before the war, the capital received 20-24 hours of power a day, while the rest of the country got 8-15 hours. Now, because of the downed transmission lines, some provinces have more power than they had before the war. CPA officials say that their aim is to distribute power more equitably than in the past—news which will be badly received in Baghdad.

Bringing back the police

Restoring security throughout the country calls for a change of tactics. Until now, Iraqi police operations have been closely supervised by American or British forces. But, in future, the council hopes to assert much greater authority.

An ambitious plan, advanced by Mahmoud Othman, a Kurdish council member, is to get the coalition's soldiers out of the business of day-to-day urban administration and security, and to turn it over to Iraqis, who can interact more smoothly with the locals. The CPA has already said that it wants to move in this direction, but the council could speed the process—and take credit if or when the troops go.

A precedent for coalition withdrawal has been set in Fallujah, a town some 65km (40 miles) west of Baghdad. The police there held a protest last week to demand that American troops pull out of their police station, and let them patrol the streets of the town on their own. Fallujah is an obvious candidate for devolving security matters. A conservative Sunni stronghold, the town was not well-disposed to military occupation, and its distrust deepened to hatred three weeks after the fall of Saddam, when American soldiers opened fire on a crowd protesting outside a school, killing 15 people.

Police officers in the town complained that association with American troops made them targets, losing them the trust of their fellow townspeople. Threatening to quit, they gave the CPA 48 hours to answer their demands. A senior American army officer in the area described the policemen's demands as a “positive development”, showing that they felt ready to take on greater responsibility. He said that America would be tapering off its troops in Fallujah anyhow, towards what the policemen were demanding.

America is clearly anxious to get other forces on the ground, thus freeing its own troops for counter-insurgency sweeps. Currently hundreds of volunteers are being rushed through a two-day crash course—on security procedures, civic duty and the proper way to treat civilians with “dignity and respect”—after which they are posted to guard ministries, oil installations and other public buildings.

The 15-question multiple-choice graduation test does not seem designed to fail many of the candidates. An example: Is accepting cash in lieu of ID from someone who wants to enter your facility “normal behaviour”, “proper behaviour”, or “corrupt behaviour, which will cause you to lose your job and hurts the Iraqi people”? The training is intended to get more rigorous later on, but for now the CPA wants to get as many bodies as possible out there. As officials often point out, they cannot deploy a soldier or marine for each mile of power or pipeline.

The council needs to show independent strength if it is not to be perceived by Iraqis as a puppet of outside forces. The question that Iraqis put to foreigners about their current plight is not so much “What is going wrong?” as “What do the Americans have to gain by keeping us like this?” Unfortunately, there are plenty of former Baathists and radical Islamists who are happy to supply them with answers.

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Troop deployment

I'm American, get me out of here

Jul 17th 2003
From The Economist print edition

Not enough peacekeepers in Iraq, and they are the wrong sort

Get article background

AP

A policeman tries his uniform for size

WHEN General Eric Shinseki, then head of the American army, estimated in February that the post-Saddam occupation of Iraq would require “several hundred thousand soldiers”, he was rubbished by his political masters. Five months and a war later, General Shinseki's guess seems more prescient than their disparagements. The need to find fresh troops to help stabilise the country, and non-American ones in particular, is pressing.

There are currently around 160,000 coalition soldiers in Iraq. Of these, 147,000 are Americans, and most of the remaining 13,000 are British. Too few, say the critics, and the wrong sort, for two reasons. First, many of the Americans now being asked to keep the peace are the same ones who waged the war. Much of the Third Infantry Division, which did a lot of the fighting, still doesn't know when it can go home. More peacekeepers should have been readied to move in behind the fighters, to quell the lawlessness that ought to have been anticipated. Indeed given its global (or, as some would say, its imperial) commitments, America should be less disdainful about peacekeeping skills in general.

Second, the security effort might seem less like a triumphal occupation if it were more diverse. To be fair, the Pentagon has issued plenty of invitations. Nineteen countries already have boots on the ground in Iraq; 19 more have promised to lend a hand, and 11 others are said to be thinking about it. Nine (mainly European) governments have proffered a total of 5,500 people to help the British run a southern Iraqi zone: some are already there, and the others are due to turn up later this summer. Around 20 countries have pledged to support Poland, which should itself have some 2,300 people in Iraq by next month, and is supposed to take charge of a zone between the British one and the American one in Baghdad.

But all that has not yet made much of an impact on the overall size and complexion of the coalition force. Some 30,000 Iraqi police are said to be back on the streets, but a new Iraqi army has yet to be recruited. Donald Rumsfeld, America's defence secretary, acknowledges that the American commitment, which has proved more costly in cash ($3.9 billion a month) and blood (33 combat deaths so far since the end of “major combat operations”) than many expected, is unlikely to be reduced any time soon. A large Indian deployment, which had seemed possible, would have made a difference. But the Indian government decided this week not to send it, though it said it might reconsider if there were an explicit UN mandate.

The same goes for the French and some other NATO countries. And without a fresh UN resolution, it might be tricky for NATO itself to take on a bigger role in Iraq, as some American congressmen would like. The alliance is giving some logistical help to the slightly improbable Polish effort, but already has its hands full in Afghanistan and the Balkans. The UN has an envoy in Iraq, who played a significant part in the country's political devolution. Indeed, the UN seems to be slowly assuming more responsibility. But America is not yet ready to formalise its role.

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The Bush administration

In the grips of a delayed mid-life crisis

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From The Economist print edition

Reuters

White House officials have always said the next election will be closer than anyone expects. This week, it began to be clear why

ALL administrations suffer a mid-life crisis. George Bush's is no exception. The oddity is that it is happening now. Partly because of the terrorist attacks of September 2001, the mid-term elections were a triumph for Republicans. Instead, the malaise is setting in little more than a year before the next presidential election.

The central feature of mid-term blues is disillusionment. Each president's virtues turn out to be less than they seemed and the costs of his policies greater than expected. And this disillusionment tends to beget internal squabbling, half-truths and, sometimes, just bad luck. All these features have been on display this week.

On the campaign trail, Mr Bush promised he would not be a president whose every utterance had to be carefully parsed to see what he was really saying (unlike you-know-who). “Americans do not want a White House where there is ‘no controlling legal authority’,” he said. “I will repair the broken bonds of trust.”

What then, to make of his claim in the state-of-the-union speech in January that “the British government has learned that Saddam Hussein recently sought significant quantities of uranium from Africa”? The White House has now admitted that as far as American intelligence is concerned, this information about Iraq's uranium dealings was bogus.

In what can only be called a Clintonesque manner, the administration has been reduced to saying the claim was right in a narrow sense. “It's technically accurate”, says Donald Rumsfeld, the defence secretary; “The British have said that,” says Condoleezza Rice, the national security adviser. British spies still maintain that Iraq was seeking uranium from Niger. But they did not tell the Americans their reasons for believing this at the time of the president's speech. This is hardly the straight shooting Mr Bush promised.

Unless WMD are found soon, the fuss could grow (see article). Opinion polls show that 40% of Americans say they do not think the war in Iraq was worth the lives lost. Half of them think the administration intentionally exaggerated intelligence reports about Iraq's banned weaponry. And the episode may also

affect Mr Bush in a more subtle way, casting a shadow over the notion that his White House is a tight ship in which the captain has control, everyone knows their job and people take responsibility for their actions.

After all, it is hard to claim the administration was ignorant of the doubts about the uranium claim. The CIA managed to get references to the African uranium taken out of another speech by the president, and its director, George Tenet, then told Stephen Hadley, the deputy national security adviser, of the agency's scepticism, even if later the CIA did not veto the inclusion in the state-of-the-union speech. Joe Wilson, an American diplomat who served in Iraq, was dispatched to Niger in February 2002 to ferret out the facts. His account is classified but he argued, in an article for the *New York Times*, that “there's simply too much oversight over too small an industry for a sale to have transpired.”

So why put it in the state of the union? The best explanation is that a group inside the administration consistently disbelieved the evidence before it. Even if these hawks are eventually proved right, it will be hard to shrug off Mr Bush's remark as just a one-off error, or a slip-up by the CIA, as Mr Tenet has loyally been saying. As for the explanation by the outgoing White House spokesman, Ari Fleischer, that Mr Bush's state-of-the-union speech referred to something entirely different from the claims debunked by Mr Wilson and the CIA, that too stretches credulity.

Stretching credulity might also apply to the other source of embarrassment for the administration this week: the announcement that this year's budget deficit will be $455 billion, the largest ever in dollar terms (see article). Of course, everyone has known the deficit is up. Even so, the scale of the reversal has been huge: the deficit is 50% larger than the $304 billion forecast in February and, as a share of GDP, there has been a six percentage-point decline from the 2000 budget surplus.

As with the claims about uranium, the administration's defenders seem to be stretching the point. Josh Bolten, the new budget director, claims the deficit is “manageable”, that most of it was the result of spending to offset recession and fight the war on terror (ie, certainly not the result of tax cuts) and that economic growth will spur revenues and close the gap.

All these things are possible, but are they credible? Just to take one point, federal spending has increased by 18% in Mr Bush's first two years—far more than the forecasts allow for in the future. The non-military component has been rising by more than 6% a year, which makes blaming it all on the war on terror seem strange. And the forecasts do not include the costs of war in Iraq, which are unpredictable.

When you have the mid-term blues, even the sure things tend to go slightly awry. This week was supposed to end with a celebration of Anglo-American amity, with a speech to a joint session of Congress by Tony Blair, Britain's prime minister. For many Americans, Mr Blair's staunch support in Iraq showed more clearly than almost anything else that Mr Bush's case for overthrowing Saddam was morally right, not just America throwing its weight around.

So it is symptomatic of Mr Bush's troubles that even friendship with his closest ally has been overshadowed not just by the uranium episode, in which Britain has a walk-on part, but by other matters. Britain has been urging America to put more soldiers into Iraq and to resist any temptation to pull out early. It has been privately urging America to step up the search for weapons of mass destruction. And it is unhappy about America's plans to try British prisoners held at Guantanamo Bay in special military commissions.

Of course, none of this will necessarily doom the much-prized special relationship, just as Mr Bush's mid-term wobble will not necessarily endanger his re-election chances next year. Other presidents have bounced back from much worse, notably Bill Clinton, who was humiliated in the 1994 mid-term elections, but won by a landslide in 1996. The differences for Mr Bush are that his troubles are mild, which is to his advantage, and that he has less time to recover, which is not.

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The budget deficit

A surplus vanishes

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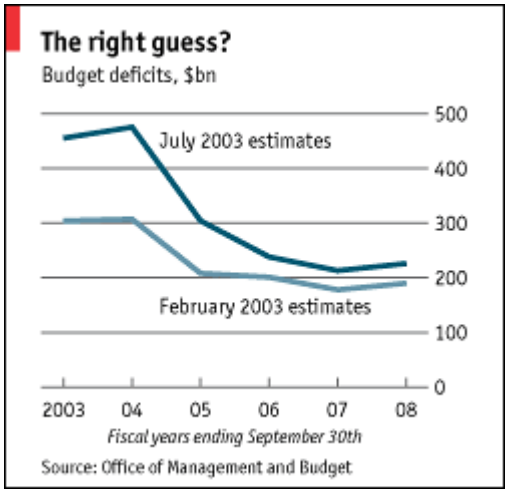
Where did all your money go?

THREE years ago George Bush was asked during a debate what he planned to do with the projected budget surpluses if he won the presidency. He said he would use half to shore up Social Security, a quarter for “important projects”, and a quarter for tax cuts.



Americans certainly got their tax cuts: some $2 trillion worth over the next ten years. They also got whopping budget deficits. On July 15th the administration's Office of Management and Budget (OMB) released its mid-year budget review. Since the budget was proposed in February, the projected deficit has increased from $304 billion for this fiscal year to $455 billion. That is 4.2% of GDP, less than the 6% reached under Ronald Reagan, and the figure will eventually fall as the economy recovers, but there will be no return to surplus.

How could a surplus, estimated in 2001 at $5.6 trillion over the next ten years, vanish so quickly? Mr Bush's three tax cuts are partly to blame: the OMB reckons they account for 23% of the difference between the original surplus predictions and the current deficit. But spending has played an equally large role, with costs rising on both military and domestic programmes. And the OMB blames more than half the total decline on the economic slump.

During the internet bubble, managers exercising fat packages of stock options paid a lot of tax at once, instead of a lesser amount spread over several years. Big bonuses pushed employees into higher tax brackets. And the ever-rising stockmarket produced unprecedented capital-gains-tax revenues.

The OMB took too long to realise that those heady days will not return. In 2001, long after the bubble had burst, it was projecting tax revenues to remain at record levels well into the new millennium. Instead they have fallen sharply. The OMB has also been too optimistic about economic growth. Had it used the Congressional Budget Office's forecast of growth of 2.5% in 2003, rather than its own figure of 2.9%, the current revision, based on growth of no more than 2.3%, would have been less jarring.

Are the OMB's long-term projections any more accurate? Its figures do not include the cost of keeping soldiers in Afghanistan and Iraq beyond 2003. And the “sunset provisions”, phasing out some of Mr Bush's tax cuts, will probably never go into effect. A paper from the Tax Policy Centre in Washington, DC, puts the ten-year costs hidden by these phantom sunsets to be $2.3 trillion.

Even more worrisome than the probability of future tax cuts is the certainty of future spending increases to deal with the retiring baby-boom generation. An American Enterprise Institute paper, to be published this month, calculates that the present value of unfunded spending obligations, mostly for Social Security and Medicare, is more than $44 trillion. A new prescription-drug benefit will push that up further. Mr Bush has delivered the tax cut. His other pledges may take a long time to get honoured.

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Weapons of mass destruction

Mass irritation

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From The Economist print edition

Why the quarrel over the case made for the Iraq war could grow

THE British didn't share their intelligence with the Americans. The Americans didn't share their misgivings with the Brits. The CIA didn't share its doubts directly with the president before his state-of-the-union address, so his aides are blaming George Tenet, the CIA's chief, for the unfortunate remark it contained about Iraq trying to import uranium from Africa. Mr Tenet accepted the blame, though he hasn't fallen on his sword. Might this fiasco turn out to be symptomatic of wider failings, or even fiddlings, with the intelligence that was used to justify the war?

The stories from spies were certainly not the only reason to believe that Saddam Hussein had weapons of mass destruction (WMD). There were the UN weapons inspectors, who couldn't find out what illegal munitions and agents Iraq still possessed. On the brink of war, they reported a “strong presumption” that 10,000 litres of Iraqi anthrax might still exist. And there was Mr Hussein himself, who used chemical weapons in the 1980s, and spent much of the 1990s hiding his WMD programmes from the UN, at great cost to his country. With help from defectors, inspectors still managed to uncover some frightening ambitions and advances. Mr Hussein's trickiness in the run-up to the war suggested that he was still hiding something.

All this made removing him seem a good idea to many people. But to make it seem even better, Britain and America made other, more specifically blood-curdling claims. The dodgy uranium tale didn't appear in the famous presentation made to the UN in February by Colin Powell, America's secretary of state, but other allegations did—not least the thin theory of a connection between Baghdad and al-Qaeda. Mr Powell also alleged that Iraq retained up to a few dozen Scud missiles, and that biological warheads had been dispersed across western Iraq. George Bush also said in his state-of-the-union speech that Iraq had “upwards of 30,000 munitions capable of delivering chemical agents”. During the war, the coalition was persuaded that chemical weapons had been deployed by the Iraqis.

Many claims, few results

Messrs Bush and Blair point out that the uranium claim was only one plank in their case for war. Ditto the notion that some Iraqi WMDs could be ready within 45 minutes of an order to use them, which was advanced in a British intelligence dossier last year. That idea has for weeks been causing Mr Blair the sort of acute embarrassment that the relative docility of Americans (a surprising number of whom apparently think that Iraq actually used chemical weapons during the war) had spared Mr Bush until recently. The trouble is that almost nothing has yet come to light to substantiate any of the other planks of the Anglo-American WMD argument.

Advancing American troops did come across some abandoned chemical-protection gear. Some documents and kit related to Iraq's nuclear efforts were unearthed at the end of June—but they had been buried 12 years ago, so hardly constitute proof of an ongoing and imminent threat. American claims that two suspicious trailers discovered in Iraq were biological-weapons labs have been disputed, including by some Americans. It is of course a boon that nobody was gassed during the fighting; but had Mr Hussein indeed deployed WMDs to the battlefield, they at least should have turned up. But they haven't.

On balance, the finds so far are less damning than the meagre ones made by the UN inspectors during their abortive pre-war mission. That may well change. But various excuses have been emanating from Washington and London.

“Intelligence” is now said to imply that Mr Hussein destroyed many of his weapons just before the war—

surprising, if true. They may have been dismantled and hidden, along with the means of making them. A professional effort to find them, overseen by former inspectors, is said to be only just beginning—another surprise, given the scale of the alleged threat, and the danger of terrorists and renegade Saddamites getting their hands on WMDs.

The most promising leads may come from mid-ranking Iraqi scientists. “Dr Germ” and other captured henchmen have evidently been tight-lipped, perhaps because they think they will get in more trouble for revealing things than for concealing them. A proper incentive and immunity scheme for ordinary boffins, and ideally the capture or demise of Mr Hussein, should help to make them co-operate.

Some American and British officials have been talking about uncovering weapons programmes, rather than the things themselves, and perhaps only guilty paperwork. But just as they once demanded that Mr Hussein prove a negative (that he had no WMDs), Messrs Bush and Blair will be urged to prove their pre-war positive (that he did). It is unlikely to be enough for them to say, like an inquisitor condemning a witch, that the absence of evidence only illustrates Mr Hussein's devilish cunning.

Until that proof appears, other readings of the case for toppling him cannot be ignored: that the vaunted intelligence was not very intelligent; that it was clumsily analysed (Donald Rumsfeld, Mr Bush's defence secretary, says that old intelligence looked different after September 11th); or, as some continue to allege, that it was distorted by politicians bent on war.

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The Tennessee Valley Authority

A valley in the shadow of debt

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A great southern institution celebrates a troubled 70th birthday

A CONCERT HALL in Nashville, Tennessee, an inn at the foot of the Appalachians in north Georgia, a cinema in Paducah, Kentucky: the electricity they all need comes largely from the Tennessee Valley Authority. Created in 1933 to manage the Tennessee river, the TVA became a symbol of federal money rebuilding the South. On July 21st, a special congressional hearing will take place in Knoxville to celebrate its achievements and question its future.

Nowadays the septuagenarian is judged less as a social worker than as an electricity-producer for one of the South's more entrepreneurial regions. America's biggest public power company supplies electricity to 8.3m people in seven states. Some of that electricity still comes from its dams; but 60% comes from outdated coal-fired power plants. How can an organisation that is mired in debt and under pressure to clean itself up cope with increasing demand?

Ever since the 1950s, the TVA has been largely self-financing: its power sales bring in $6.8 billion a year and it made an operating profit of $1.65 billion in its last financial year, ending in September. But $1.4 billion of this was gobbled up by interest payments on its huge $25-billion debt pile.

The TVA is prohibited by law from issuing more than $30 billion in bonds in total. Yet money is what the TVA needs to modernise. The demand for its power is expected to climb by 2.8% next year. The TVA has built no new coal-fired stations since 1973, and its current stock of 59 coal-fired plants, many of which were built in the 1950s, needs improvement.

Coal plants are messy. Since 1977 the TVA has spent $3 billion on reducing nitrogen-oxide and sulphur-dioxide emissions, and plans to spend $2.6 billion more by the end of 2010. John Shipp, its vice-president for environmental policy and planning, acknowledges that the last few billions will not remove nearly as many emissions as the first few.

The TVA's managerial skills are open to question. Stephen Smith, executive director of the Southern Alliance for Clean Energy, blames the TVA's debt on its decision to build nuclear plants in the late 1970s. Of 17 planned nuclear sites, eight were cancelled and two are not functioning. The TVA's board of directors is appointed by America's president. “You end up seeing politicians parking their friends,” says Mr Smith, who calls the current board “hacks with no vision or experience”.

A power grab

This is a little unfair. When the Office of Management and Budget (OMB) issued its ratings of federal agencies in May, it gave the TVA generally high marks. But it did scold it for lack of a debt-reduction plan. A plan afoot in Washington, DC, would forbid the TVA to take on any more debt without first submitting a business plan to the OMB. That would virtually put it under Washington's direct control.

It is unlikely that the TVA can get the money it needs from what it charges its customers. Earlier this year it proposed a rate increase of 8.1%, starting on October 1st, for most of its purchasers (though some industrial customers would actually see their rates go down). That would have raised only $365m. After howls of protest from the customers, mostly municipal power distributors, it cut the increase to 7.4%. It may now drop it altogether.

Are there any alternatives? The TVA talks proudly of its “green power” initiatives, such as wind turbines, but Mr Shipp reckons that only about 1% of its electricity output is generated by such things. Another project, costing $1.8 billion, is to re-start the third reactor at the Brown's Ferry nuclear site in northern Alabama, which has been shut since 1985, when the TVA closed all its nuclear reactors because of worries about their safety.

It may just limp wearily on. The Brown's Ferry plan fits in nicely with President Bush's hopes of expanding nuclear power. But some people are asking themselves whether tougher things need to be done. On July 14th, Lamar Alexander, Tennessee's new senator, who is chairing next week's Knoxville meeting, announced plans to co-sponsor the Clean Air Planning Act, which would impose tougher emission reductions than Mr Bush's Clear Skies Act, now favoured by TVA officials. Will Mr Alexander insist that the TVA clean up its plants, and its books, without raising prices? If he does, a 70-year-old dog will have to learn some new tricks fast.

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About sponsorship

Remember tobacco?

Have a whiff of a wicked old habit

Jul 17th 2003 | DURHAM AND KENLY, NORTH CAROLINA
From The Economist print edition

For the chestily incorrect, some places you may like to visit

TRY to buy something—anything—in the gift shop at R.J. Reynolds's Whitaker Park factory in Winston-Salem, North Carolina, and you will politely but firmly be turned away. Not only is the sale of tobacco *verboten*; so is anything bearing the logo of one of RJR's famous cigarette brands, from a porcelain desk sculpture of a camel to a lapel pin celebrating the Winston Cup car races. A sign, prominently displayed, explains: “In compliance with the comprehensive tobacco settlement, effective 7/1/99, brand-logoed merchandise can only be sold to active RJR employees with valid company identification.”

To people with generations of ancestors who lived in tobacco-growing areas, all this seems mighty depressing. Tobacco gave their region an unprecedented prosperity. You'd be writing revisionist history if you ignored that, says Harold Jacobson, curator of the Tobacco Farm Life Museum in Kenly. But in recent years tobacco companies have largely abandoned their efforts to attract tourists to their works. RJR ended its factory tours in January 1998, explaining that visitor numbers had dropped by two-thirds since the 1970s. The company did keep its Winston-Salem museum open—it includes a call to smokers to lobby for their “rights” and a human-sized camel sculpture made of real tobacco—but tobacco aficionados with an urge to watch the manufacturing process in action have essentially run out of options.

As long ago as 1993 RJR's main rival, Philip Morris, cancelled tours of its place in Richmond, Virginia, because of “resource constraints”. The National Tobacco and Textile Museum in Danville, also in Virginia, has closed its doors. Even the US Smokeless Tobacco Company, the maker of Skoal and Copenhagen snuff, gave up its Museum of Tobacco Art and History in Nashville, Tennessee, in 1999.

Still, a handful of hardy non-profit museums remain open. Many have given up tobacco-company grants, and all have bowed to current sensitivities about the demon weed. The museum in Kenly, just 20 years old, now celebrates the heritage of the region's tobacco farmers—from early kitchen life and local children's games to the process of heat-curing tobacco—but ends the tale as soon as the crop is carted off to auction. In 1992, after a wrenching debate, the board decided to scuttle the museum's original name, the Tobacco Museum of North Carolina, in favour of the softer “farm life” theme.

Just to the north, over the border in South Hill, Virginia, the Tobacco Farm Life Museum of Virginia has a similar approach. With a modest amount of local capital, the museum opened a restored brick building in 1997. “Everything we have here was donated to us; we haven't purchased anything,” says its curator, Max Crowder, son of a tobacco warehouseman. About 2,000 people a year visit it, not bad for an out-of-the-way newcomer.

In Durham, North Carolina's state government runs a museum that preserves the Duke Homestead, the site of the tiny factory where Washington Duke, a discharged Confederate soldier, set up the enterprise that would eventually become the gargantuan American Tobacco Company. Earlier this year the museum, now almost 30 years old, unveiled a new introductory film. The original film, which began showing in 1980, had long produced complaints that it was “too pro-tobacco”, says the museum's manager, Dale Coats. Like similar museums, Mr Coats laments, the Duke Homestead has difficulty finding private donors who think the preservation of tobacco history worthy of their money.

Elsewhere in Durham, efforts are under way to find new uses for the city's plethora of old, abandoned tobacco buildings. One project, called West Village, which opened in 2000, turned 325,000 square feet into 241 loft apartments—96% of which are now occupied—and a commercial zone which is fully used. Another conversion, designed to re-make Durham's old American Tobacco Company complex into a mixed-use development, got under way this spring, and will have Duke University, GlaxoSmithKline and Compuware among its tenants. When the first stage is finished, in mid-2004, it will have 1,800 people

working there, about as many as American Tobacco had in its prime.

Asked whether he is proud to transform the legacy of what many people think of as a sin, Tom Niemann, the developer of West Village, pauses. His father, he says, smoked three packs of Chesterfields a day and suffers from emphysema. Still, “that's not what drives me. I never made a judgment on the industry.” A century ago, tobacco made Durham what it is. That includes the establishment of Duke University, one of America's best. “I'd like to think that, in the future, when people haven't smoked for 100 years, our buildings will still be standing.”

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California

Gaze at a tragedy in slow motion

Jul 17th 2003 | LOS ANGELES
From The Economist print edition

The recall, the budget crisis and a state gradually slipping out of control

AFP

"...and then the undervalued grey man lived happy ever after"

Get article background

A FAVOURITE fixture on Los Angeles TV is the police car chase: a motorised malefactor, followed by a squad car, moving with curious lethargy through the city's maze of palm-shaded streets and bumpy concrete freeways. You can watch for hours, expecting a spectacular crash or at least a dramatic pulling-over, but nothing happens. So it is, too, with Californian politics. Two big chases—a recall of the Democratic governor, Gray Davis, and the struggle to pass a budget—are proceeding in extraordinary slow motion.

On July 14th, the organisers of the recall gathered on the steps of the State Capitol and said they had gathered, by their estimate, 1.6m signatures, or enough to produce the required 897,158 valid ones. At present, as county officials tot them up, the validation rate is running at around 80%.

Final figures are meant to be delivered to Kevin Shelley, California's secretary of state, by July 23rd. But Mr Shelley, as a good Democrat, is in no hurry to receive them. The bigger counties, such as Los Angeles, may well be allowed a month more. The longer the process can be dragged out, the more likely it is that a recall election will not be held until March, coinciding with the presidential primary, when a good Democratic turnout may just save Mr Davis's neck. Courts can delay matters, too, and Mr Davis's backers are filing suit to claim that the signature-gathering itself, by hired out-of-state mercenaries, was illegal.

The Republicans are filing a counter-suit to enforce the deadlines, but most are confident that the governor is on the ropes. After a strange spell of silence, Mr Davis—his white hair and strained face giving him a ghostly look—has hit the radio talk-shows and the primary-school photo-opportunities, trying to make his case. He has also wheeled out important friends, such as Warren Christopher, a former secretary of state, and Eli Broad, a property magnate, to predict doom if he goes.

Now that the thrill of direct democracy has subsided—no more young men with clip-files smilingly

approaching you at the supermarket—unease has taken its place. There are no compelling grounds for removing Mr Davis; he is merely the most prominent of the few local politicians Californians know, and so takes the blame for the mess the state is in.

In order to preserve some semblance of loyalty (at least until the governor's case is judged hopeless), no Democrat is coming forward as an alternative. Some are fantasising that Mr Davis may resign in favour of his deputy, Cruz Bustamante, whose hold over the Latino vote could make him hard for Republicans to beat. But Mr Davis looks like a man who will hang on grimly, despite approval ratings of only 20%.

Replacements are no more obvious on the Republican side. Darrell Issa, a southern Californian congressman and car-alarm tycoon who financed the recall effort when it was floundering, is even less popular than Mr Davis. A paltry 3% of registered voters say they would choose him. Richard Riordan, a former Republican mayor of Los Angeles, is perhaps the closest to a favourite. Hopes that Arnold Schwarzenegger might inject muscle, accent and attitude into the job seem to be fading (his latest film is doing only moderately well). But since, in law, anyone can run in a California recall election if they gather 65 signatures and pay $3,500, other interesting bids are starting to come in. One possibility: Angelyne, a buxom Hollywood celebrity, who has previously auctioned her underwear in order to raise the pennies to run for office.

This political chaos might be fun, if it did not coincide with fiscal meltdown. But California is now almost three weeks past the deadline for closing a budget deficit of $38 billion, the biggest in any state—and California had estimated general-fund revenues for fiscal 2003 of only $68 billion. There is a striking lack of serious thinking about this problem, too; but by July 20th Californians may start to notice, as the unpaid highway crews stop work.

Mr Davis has proposed to bridge the gap mostly with tax increases: half a cent on the sales tax, higher taxes on tobacco and wealthier Californians, and a tripling of the vehicle-licence fee. His Republican opponents would rather slash spending on education, health and welfare and get rid of the California Coastal Commission (bane of seaside developers), a programme to stop teenage pregnancies, and payments for the burial of foster-children and for food for guide-dogs for the blind.

There is cartoon posturing in this, but some of it may happen. Only about 20% of the budget is open to negotiation; the rest is either hypothecated by previous propositions, mandated by federal law or tied up with guaranteed pensions and salaries for state employees, including teachers. Within that 20%, the power to forge a compromise lies mostly with the Democratic and Republican leaders in the state Senate.

Already the shape of that compromise looks clear: defer the pain of both tax increases and deep spending cuts until next year, fiddle a little and borrow a lot. This comes despite the fact that California's credit rating is now only a little above junk, and that the north, in particular, has yet to emerge from the dotcom bust.

In all this chaos, Mr Davis seems little more than a complaining voice off-stage. At the best of times, he never had his own man in the legislature. Now he is so weak and besieged that, in the opinion of Sherry Jeffe, a political analyst, he will sign any budget deal that is put before him. Either way, the position for both him and his state looks as parlous as that of the malefactor threading through Los Angeles, only inches ahead of the relentless LAPD.

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Lexington

Don't write off John Kerry

Jul 17th 2003
From The Economist print edition

But first he must learn how to play the Vietnam card

WHAT'S up with John Kerry? In more normal times he would be the Democratic front-runner, setting the pace, soaking up publicity and creating that all-important sense of inevitability. He is not only a well-known senator from the Democratic power-house of Massachusetts. He is also a decorated Vietnam-war veteran who was thinking seriously about international terrorism back in the days when George Bush's idea of foreign policy was a day trip to Oklahoma.

Yet he is forever lost in the crowd. Today the man in the limelight is Howard Dean. A few months ago it was John Edwards. Dick Gephardt can take comfort from the fact that he is the favourite to win the Iowa caucus. Joe Lieberman leads the field in name-recognition. Even Al Sharpton can boast of being a front-runner—among black Americans. Mr Kerry is earning a reputation as the man who is not doing as well as expected.

Mr Kerry has suffered from being an embodiment of the Democratic establishment at a time when the party's grass-roots are in the mood for rebellion. Rather than admiring his lantern jaw and senatorial manner, the populist wing of the Democratic Party mutters about his blue blood and aloof manner. Rather than admiring his sophisticated straddle on the Iraq war (he voted in favour of giving Mr Bush war powers but then relentlessly sniped at him for “rushing to war”), they despise it as being the typical fence-sitting of a Boston Brahmin whose middle name is Forbes, who was partly educated in Switzerland and who married a Heinz heiress. If Mr Kerry talks down to ordinary people, it is not just because he is six-feet-four-inches tall.

At the same time, the party's conservative wing distrusts his liberal Massachusetts politics. He worked with Michael Dukakis (as his lieutenant-governor) before joining Ted Kennedy in the Senate. He opposes the death penalty and drilling in the Arctic National Wildlife Refuge, supports gun control and favours “constructive engagement” with Cuba. Try selling that in the South.

All this helps to explain why Mr Kerry has found the primary season harder than expected. But none of it means that his goose is cooked. Remember how quickly the John Edwards boom faded as he was exposed to scrutiny. The spotlight on Mr Dean will reveal the insurgent's faults as well as his virtues. At one July 4th parade Karl Rove, Mr Bush's chief strategist, was overheard laughing as a group of Dean

supporters marched past: “Yeah, that's the one we want.” Mr Rove's enthusiasm for the populist doctor will surely give many Democrats pause for thought.

The man from Massachusetts, on the other hand, still brings three big advantages to the long race for the Democratic nomination. The first, paradoxically, is those establishment credentials. Mr Kerry's top-down strategy of building support by wooing the party bosses is less exciting than Mr Dean's internet-enabled insurgency. Other leading Democrats, notably Dick Gephardt, are competing for the same endorsements. But bear in mind that the top-down approach usually works. The last insurgent candidate to win the White House was Jimmy Carter. The current president, George Bush, saw off a highly charismatic insurgent, John McCain, by means of a classic top-down strategy.

This time, the Democratic establishment has all the mechanics of politics on its side, from the compressed primary calendar to the system of allowing “super-delegates” (such as elected officials and “distinguished party leaders”) to cast 37% of the votes needed for a nomination. At the moment the establishment is divided, of course. But it will eventually unite behind a champion, and will do so all the more enthusiastically if the Dean insurgency continues to build momentum. Mr Kerry has a better chance of becoming that champion than anyone else.

His second advantage is that, despite the jeers about being a Dukakis clone, Mr Kerry is a centrist. His opposition to the first Gulf war was an exception to his general support for action abroad. He has criticised two of the liberals' sacred cows, affirmative action and the education establishment, while supporting free trade and welfare reform. His hobbies include hunting. He can be positively poetic about the subject of killing and gutting doves, quail and deer. That does sell in the South.

Mr Kerry's third and biggest advantage is his record in Vietnam. He served two tours of duty, earning a Silver Star, a Bronze Star and three Purple Hearts for being wounded before returning home to join the critics of the war. The way he conducted himself while in Vietnam suggests he would know how to take tough decisions in an age of global terrorism. He knows more about the sharp end of war than the president, vice-president or any of those war-mongering draft-dodgers.

Of Saigon and Iowa

So far Mr Kerry has squandered the huge advantage that he earned in the jungles of Vietnam. He continues to send hopelessly mixed signals on the war in Iraq. It is understandable that he should try to exploit the current flap about the White House's use of intelligence. But it still looks as if the best chance the Democrats have of challenging the Bush re-election machine is to be just as tough as he is on international terrorism. And the only chance Mr Kerry has of standing out from the rest of the Democratic field is to turn his war experience to his advantage—demonstrating that he understands not just the pity of war but also its necessity. Mr Kerry needs to stick out his lantern jaw and proclaim that America will pay any price and bear any burden to defeat terrorism.

Mr Kerry won his Silver Star by ordering his patrol boat straight into a Vietcong ambush, all guns blazing. This looked foolhardy to some other commanders, but it threw the guerrillas into disarray—and Mr Kerry carried the day. Let him show the same all-guns-blazing appetite for warfare when dealing with Mr Dean's guerrilla forces in the Democratic primary.

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Politics in Brazil

Lula comes under friendly fire

Jul 17th 2003 | RIO DE JANEIRO
From The Economist print edition

Reuters

Discontent among two groups of traditional supporters of the governing Workers' Party poses a first big test of the president's political skill

Get article background

HE IS a 57-year-old greying former metalworker, but Brazil's president, Luiz Inácio Lula da Silva, inspires abroad the sort of reception normally given to teen pop stars. At a packed lecture at the London School of Economics this week, Mr da Silva was greeted by delirious cheering as he spoke of his determination to change Brazil. At home, too, after six months in office he remains extraordinarily popular, approved of by 78%, according to a poll this week. But his centre-left government is less so. It is facing the first serious challenges to its reform plans, which have put it on a collision course with some of its traditional supporters.

Much of the government's initial effort has gone on successful measures to shore up Brazil's fragile finances. These have involved not just tighter monetary and fiscal policies which have temporarily brought growth to a halt, but also a vital bill to curb generous public-sector pensions. But the government has been far slower to address the social and political issues which Mr da Silva made the centre of his campaign last year. Now, it faces pressure to do so—just when it is also running into difficulties over pension reform.

In opposition, Lula and his left-wing Workers' Party (PT) opposed attempts to rationalise a public-sector pension system whose shortfall stands at $19 billion a year. In office, he quickly changed his mind. Most of Brazil's political parties support reform, as do the state governors, whose finances are worst affected by the pensions' black hole. But many of the PT's traditional supporters disagree.

Trade unionists once loyal to the president booed him in São Paulo last month. Four prominent members of the PT face expulsion for speaking out against the reform. Lula, who led strikes against a military government in the 1970s, is now the target of an indefinite strike begun last week by federal civil servants. Backing for this is patchy. But with the judiciary defending its pension privileges too, the government retreated in disarray.

Last week, party managers offered to backtrack on a central plank of the reform, a clause which would end the practice of workers retiring on 100% of their final salary. But that in turn prompted an outcry from the governors. This week, a compromise seemed to be emerging that would see some workers able to retire on full salaries, but not new recruits and only those who fulfilled new, far stricter, rules on

retirement age and length of service. That would not be fatal to the reform.

Pension reform is vital partly because the government faces pressure to spend more in other areas. The most militant demand comes from the Landless Movement (MST), the most prominent of the groups seeking agrarian reform. The MST has traditionally been close to the Workers' Party's more radical elements. To help Mr da Silva win last year's election, it ordered a moratorium on land invasions during the campaign. But in March it called off its truce. In the three months since, it has staged 117 protests (14 more than in the whole of last year), including land invasions and highway blockades.

The principle of land reform is widely accepted in Brazil. Its practice is more questionable: it has often resembled an expensive rural welfare programme. But the president is sympathetic to the MST. Last week, he met the movement's leaders. They asked him to settle 120,000 families immediately, and 1m by the end of his four-year term. The government lacks the money for anything like that. Its target is to give land to 60,000 families in its first year, a similar rate to the previous government. Even that will be hard: only 2,500 families got land in the first six months. Instead, officials say, they helped 825,000 small farmers with debt forgiveness and $1.9 billion in aid.

The MST's protests have brought an angry response from ranchers and landowners. Some are threatening to form armed militias to protect their property. At least one man was injured when hooded men shot at an MST camp. In Brasília, the Senate is due to open a potentially damaging parliamentary inquiry into the group next month. The powerful farming lobby, numbering more than 150 deputies, has warned Lula that if the government wants its votes it must rein in the movement.

It shows no sign of doing so. Miguel Rossetto, the agrarian reform minister, says that the thousands of families in the MST's roadside camps will be given priority over those who register for land in other ways. That will merely entice others to set up camp. Some see this as a way of forcing the president's allies in the centre to accept that more money should be given to agrarian reform. “It's a political dispute inside the government. [Lula] has to enact agrarian reform sooner or later or the countryside will explode. It's as simple as that,” argues Ariovaldo de Oliveira, a geographer at the University of São Paulo.

Perhaps so, but for the president matters are more complicated. Worthy as land reform is, if equity is the goal, the money might be better spent on, say, secondary education or the government's new youth-unemployment scheme. And though the economic team has quickly acquired a reputation for competence, the same does not go for much of the rest of the government, in which many second-tier posts remain unfilled.

Lula owes his presidency not just to his traditional supporters, but to his success in persuading tens of millions of ordinary Brazilians that he would combine social justice with order and stability. Keeping their support means playing radicals and conservatives against each other. From now on, much will depend on the skill with which Brazil's president does this.

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Terrorism in Peru

Flickers from the past

Jul 17th 2003 | LIMA
From The Economist print edition

How big a threat is the Shining Path?

Get article background

MORE than a decade after the capture of its leader, Abimael Guzmán, ended the bloody insurgency by the Sendero Luminoso (Shining Path) guerrilla movement, Peruvians are once again worried about terrorism. Last year, a bomb exploded at a Lima shopping centre days before President George Bush was due to visit the city, killing nine people. Recent attacks suggest a more extensive Sendero revival. Last month, 71 workers at Camisea, a big natural-gas project, were briefly kidnapped, gaining the rebels headlines abroad (and maybe a ransom). Last week, five soldiers and two civilians were killed in a clash near the remote Apurímac river.

Peruvians are traumatised. The war unleashed by Sendero, a fundamentalist Maoist group, from 1980 to 1993 left some 30,000 dead. The group was apparently crushed and most of its leaders imprisoned, thanks to public rejection, good police work and the strong-arm methods of Alberto Fujimori, Peru's authoritarian president of 1990-2000.

But it never entirely disappeared. A rump remained in the Apurímac and Huallaga valleys, which has now become more active. Small groups of well-armed rebels have raided villages along the Andean cordilleras, from Piura to Puno, and occasionally attacked police posts. They have rounded up locals for political talks, admitting past “errors” and claiming to have renounced terrorism. They are said to be recruiting a new generation of unemployed youths; with no memory of past violence and few prospects, these youngsters are happy to take the $20 a month “wage” Sendero is said to offer.

Officials insist that Sendero now has only 175 armed men and women. But some security experts blame President Alejandro Toledo's democratic government for its revival. Under Mr Fujimori, the intelligence service was corrupt and brutal, but effective; it has since suffered budget cuts and frequent changes of staff. The army has been demoralised by purges and human-rights probes. And Mr Toledo has abandoned a promising police reform. Add in poverty and social unrest, and these are fertile conditions for agitation.

Mr Guzmán, a former philosophy professor, may have regained the power to command his followers from his prison cell in a naval base. Benedicto Jiménez, a senior policeman in the fight against terrorism, claims that prison security has become lax. He says that messages are passing regularly between the 1,700 prisoners held as terrorists, and friends outside.

After his capture, Mr Guzmán ordered his followers to surrender. He is said to be seeking an amnesty, and to favour purely political methods. The armed rump ostensibly split from him a decade ago. Whether the two groups are now in tandem again is not clear—nor whether either has links with Colombia's FARC guerrillas. What is known is that Sendero has drug money.

Mr Toledo has many enemies who are keen to exaggerate the guerrilla threat. But neither can it be safely ignored—the mistake made by an earlier government two decades ago. It would not take much to scare off foreign investors. Mr Toledo may come to rue having aborted a reform of the police and intelligence services. And he would be wise to get a grip on the jails.

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Chile

Prison SA

Jul 17th 2003 | SANTIAGO
From The Economist print edition

Can private money ease a jail problem?

Get article background

AP

Future customers rehearse a complaint

CHILEANS like to think of their country as a cut above its neighbours. But its prisons are decidedly Latin American. Santiago's main jail was built in the 1840s for 800 prisoners; it is home to over 5,000 today. With crime rising, albeit from a low level, the prison system as a whole is becoming ever more overcrowded. Now, the centre-left government of President Ricardo Lagos has become the first in South America to turn to private investors to fix its prison problem.

The government has handed out to private consortia the first two of four planned contracts to build and operate a total of ten new prisons. With space for 16,000 inmates, the new prisons will increase capacity by two-thirds. Officials hold out high hopes for the new jails. They will end overcrowding, and should be safer; inmates will no longer be allowed to cook for themselves, reducing fire risk. The hope is that prison will start to rehabilitate criminals, rather than promote recidivism (60% of Chile's prisoners reoffend).

Private prisons are also a good deal, says the justice ministry. Inmates in state prisons cost the government about $9 per day. In the private prisons, the cost will be slightly higher, but more services will be provided, such as clothing, laundry and better food. The contracts envisage a 12% profit for investors.

But some Chileans are not persuaded by the new model. The main problem is not crumbling jails but the “military mentality of the prison-guard service,” according to Alejandra Mera, a law lecturer at Diego Portales University in Santiago. In the new prisons, the operator will provide services and maintenance, but those same guards will be in charge of security.

That was a pragmatic decision. Ceding control over security would have needed a time-consuming change in the law, says the Justice Ministry. But it may cause headaches. “If a guard beats up a prisoner, we'll have to look away, although we'll be responsible for rehabilitation services,” admits Dante Bacigalupo of BAS, a consortium formed by France's Sodexho, Italy's Torno engineering group and a Chilean construction firm, which won the first two contracts. Similarly, although the operators will provide medical services, it is a prison guard who will decide whether or not an inmate needs a doctor.

The prison service promises fresh (and better-trained) recruits to guard the private prisons. But its ethos will be hard to change. In addition, the line between services and security is not always clear-cut: bad food is a potential security problem, argues a former prison governor. And if there is a riot, who will pick up the bill? It may be years before such details are ironed out. But the new prisons can hardly be worse than many of the old. They may soon be copied by Chile's neighbours.

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Reforming Colombia

A vote on Uribe

Jul 17th 2003 | BOGOTÁ
From The Economist print edition

A referendum becomes a vote of confidence

Get article background

SINCE he became Colombia's president last August, Álvaro Uribe has devoted much effort to weakening his country's rebel armies. This week, in a move intended to show the stamp of government authority, he took his ministers for three days to Arauca, an oil-rich department long under guerrilla sway. At the same time, the government announced the start of peace talks with a group of rightist paramilitaries. But as a presidential candidate, Mr Uribe also promised to clean up politics and stamp out government waste and corruption. Last week, Colombia's Constitutional Court gave the green light to a referendum on a clutch of fiscal and political reforms. In doing so, they also managed to turn it into a plebiscite on Mr Uribe's presidency as a whole.

The referendum deals with a disparate bundle of seemingly minor constitutional changes, ranging from making public the votes of congressmen to abolishing local auditors, cutting the size of Congress, trimming pensions and freezing public-sector wages for two years. The government hopes that some of these reforms will save $570m (or 0.7% of GDP) this year and somewhat more over subsequent years.

The court has made the referendum a far harder sell for Mr Uribe by striking out several measures. One was a populist proposal to tighten penalties for drug use. Another gave mayors and departmental governors an extra year in office, which would have given them an incentive to campaign for the referendum. A third allowed voters to say yes to all 19 (now 15) questions. Instead, voters will have to tick each question separately—a big setback for Mr Uribe.

Another problem concerns the date for the referendum. Municipal elections will now go ahead on Sunday October 26th, but the referendum cannot be held on the same day. Instead, it may be held the day before, in a “voting weekend”, say officials.

That would be a severe test of Colombians' electoral ardour. For the referendum to be valid, at least 25% of the electorate (6m voters) must take part. In a poll last week by *Semana*, a weekly magazine, only 23% of respondents said they would definitely vote. Almost two-thirds said they knew little or nothing of the referendum.

Confusingly, Colombia's Congress is close to approving a political reform of its own, which the government opposes. This is aimed at bringing some order to a fragmented and chaotic party system. For example, Mr Uribe, a lifelong Liberal, stood for the presidency as an independent. In all, there are 75 parties; the Liberals, by far the most biggest, ran no fewer than 148 rival lists of candidates in last year's election. In practice, say critics, individual candidates buy votes with handouts or pork.

Under the reform, a party would win seats in Congress only if it won 2% of the national vote (a provision also in the referendum). Parties would have to present a single list—but voters could cast a “preferential” vote for an individual candidate. One criticism is that the “preferential” vote would give pork-barrel politics a new lease of life. A second worry is that the new system might make life too hard for third parties. But Matthew Shugart, a political scientist at the University of San Diego in California, argues that the reform is a big step forward. It will force parties to campaign on their collective national appeal, while reducing the incentive for individual candidates to split away if they fall foul of the party leadership, he says.

To win the referendum, Mr Uribe's best bet is to turn it into a personal vote of confidence. The president remains popular, although the *Semana* poll suggests his support has recently slipped from 72% to 64%.

But with Congress showing that it increasingly has a mind of his own, he also faces a separate, if linked, battle to regain influence over his own party.

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Canadian geography

Whistling in the dark

Jul 17th 2003
From The Economist print edition

A misplaced Olympic venue

JUST where is Whistler, site of (most of) the 2010 winter Olympics? In the Rockies, two hours' drive north-west of Vancouver, we wrote two weeks ago ("Somewhat cool", July 5th). In flowed the e-mails to point out that in fact it lies in British Columbia's Coast mountains, not the Rockies at all.

Some also pointed out that while we said "50,000" people had packed "BC Place Stadium" to await the Olympic decision, in fact rather fewer of them gathered in "GM Place". Others took issue with our claim that the Coquilhalla Highway "has long been paid for" by tolls. For those errors, sorry.

But *The Economist* is not alone in its geographical confusion. How far is Whistler from the Rockies? One reader said 425km; 650, said another; 1,000, a third assured us. In fact, 500km is the best bet. And is Whistler really north-west of Vancouver? In fact it is due north. Only one reader pointed this out. Odd, that. Though maybe not: the mountain resort's own official website mysteriously puts it two hours north-west of Vancouver, just as we had. And just as wrong.

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Afghanistan

The emir of the west

Jul 17th 2003 | HERAT
From The Economist print edition

AP

Ismail Khan rules Herat with little reference to the government in Kabul

THE interior minister of Afghanistan, Ali Ahmad Jalali, gave a brave speech in a dusty Herat hotel on June 28th. On Mr Jalali's right, as he spoke, was Ismail Khan himself, the supreme warlord of western Afghanistan. On his left, a crew of Mr Khan's senior toughs, uneducated men elevated to giddy heights by Mr Khan for loyalty shown during the *jihad* against the Soviet army and later the Taliban. Before him were Herat's great and good—military bosses, paper pushers, car dealers and sugar merchants—most of them indebted to Mr Khan. Behind him was a portrait of Mr Khan with the Afghan president, Hamid Karzai, lost in the background: a reminder that Kabul is a four-day drive away on bandit-infested roads.

Still, Mr Jalali plunged in. There were some parts of Afghanistan, he said, clearly intending to include Herat, which did not enjoy free speech, places which thought to keep money to themselves rather than sharing it with the rest of the country. The new Afghanistan, he added, could only be built from the centre. Mr Khan stroked his white beard and glowered. He had looked happier earlier on, when a woman spoke of “our dear father Ismail Khan who liberated the women of Herat and whom nobody has the right to criticise.”

The following day, with Mr Jalali gone, it was business as usual. Mr Khan met with his army, paid by Kabul but loyal to him as regional commander. The central government insists Mr Khan give up his army position. His force is smaller than advertised and shabbier, perhaps 3,000 men with another 25,000 or so reservists. But it has no intention of disbanding, as Kabul demands. “I don't understand the problem. We've already said we'll change our uniform,” says a senior commander.

To his detractors, Mr Khan is Iran's man, and a corrupt conservative who helped liberate Herat from the Taliban only to turn it into another police state. Iranian-style morality patrols cruise the city looking for infringements of dress or association. Women feel pressured into wearing the burqa. Heratis have been jailed for speaking out. Key technical positions are too often taken by unqualified *jihadis*, some of them barely literate. Outside the city, Mr Khan's soldiers have shot dead dozens of innocents in botched raids, allegedly on Taliban forces. The poor's demands for wells and schools, shown on local television, only serve to burnish his image as a benign potentate. His speeches, dwelling on his *jihad*, his narrow escapes, and his fatherly aspect, show the beginnings of a personality cult.

Mr Khan, however, is popular because he offers Heratis security—something Kabul can never guarantee

for the area, and can only guarantee for itself with foreign help. Herat is the safest city in Afghanistan, a fact Mr Khan emphasised when he declined a proffered peacekeeping force on his patch. Foreign aid workers based in Herat think Mr Khan a brigand, but not of the worst order. Talk of a secret-police state after the fashion of neighbouring Turkmenistan is overblown, they say. Besides, the security afforded by Mr Khan and his *jihadis* allows the UN and other agencies to do better work in more remote places. An improvement, certainly, on the south of the country, where incursions by neo-Taliban have driven out nearly all aid workers.

Unfortunately, Mr Khan's would-be emirate has been underwritten by customs revenues intended for Kabul. The Herat customs house handles most of the country's trade with neighbouring Iran. It is a sprawling, Kiplingesque empire of ledgers and barefoot clerks, surrounded by a glinting sea of cars and containers. Mr Khan has had no problem skimming off the top for the past 18 months. The head of the customs, Abdul Azim Rahimi, estimates the official take of the customs this year to be $160,000 a day. Mr Khan's share of that has been hit by a recent agreement with Mr Karzai which saw him hand over $20m in cash to Kabul, with more to follow. But he will still be able to earn on undeclared imports and bribes: locals figure on $750 in backhanders for every shipping container they bring in.

It says much about Afghanistan that this theft is not a disaster. Mr Khan and his *jihadis* appear to live simply. Some of the customs money is even spent on improving Herat. It could have been better used, undoubtedly, but probably not by officials in Kabul. By stealing at source, the argument goes, Mr Khan is at least enriching somewhere outside the capital.

Iran looms large in the Afghan west. Opium and Afghan men are smuggled into Iran, goods and homesick Afghan refugees come the other way. Poorer Heratis are unhappy about Mr Khan's close links with Tehran. It was Iran, they point out, which disarmed Mr Khan's enemies and after the Taliban fell.

Still, there are signs that Iran now wants to sideline Mr Khan in favour of Mr Karzai, America's man. “He must fall into line with Kabul,” says a senior Iranian diplomat tartly. Iran hopes to loosen Mr Khan's grip on trade with a new border post to the south and now signs deals, such as for a new road between Iran and Tajikistan, directly with the central government. Only a stable and united Afghanistan, Iran now thinks, will rid it of its 2m Afghan refugees and stem the flow of opium across its borders. It has pledged $500m in assistance to Kabul over the next five years.

Mr Khan is a problem. But intelligence officials—American as well as Iranian—have yet to identify a replacement. He knows he will be tolerated for as long as he can guarantee security in the west. This risks anointing a destabilising personality cult. But with security problems in much of the country, little progress on poverty and infrastructure, and an exploding drug trade, it is a risk the government in Kabul will probably have to take.

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About sponsorship

Afghanistan and Pakistan

Crossing the line

Jul 17th 2003 | TUTKAI, AFGHANISTAN
From The Economist print edition

A border dispute heats up

A WAR with Pakistan is exactly what Afghanistan does not need. But that is what is brewing on the hills separating Nangarhar province in Afghanistan and the Mohmand tribal agency in Pakistan (see map in article). No one is sure where the border runs here. Pakistan holds to the Durrand Line set down by the British in 1893. Afghanistan thinks the true border is 40km (25 miles) or so beyond. UN maps corroborate this by using Afghan maps. American and Russian military maps use the Durrand line.

News-agency reports have tended to dismiss tales of repeated Pakistani incursions into Afghanistan since April. There is little ambiguity on the ground, however. Fighting at the frontline above the village of Yaqoubi has been constant for the past two weeks. The Afghan commanding officer at Yaqoubi, General Mustafa Ishaqzai, says he has fired 300 mortar shells at Pakistani positions. The Pakistanis, he claims, have shot back 3,000 shells of their own. Plenty anyway, judging from the unexploded ordnance littering the Afghan positions.

The Afghans are heavily outmanned, outgunned and chafing for a fight. The Afghan border patrol, with orders to hold the line, is hungry. Its men have not been paid since the fall of the Taliban. “We live on donations and love of Afghanistan,” they say brightly. All maintain they are ready for war and for death.

The forward Afghan post at Yaqoubi is surrounded by six well-entrenched Pakistani positions. Three weeks ago there was nothing here. Why have the Pakistanis moved forward so suddenly? To seal the border against al-Qaeda, say Pakistani soldiers digging in on a ridge above the (indisputably) Afghan village of Tutkai. “There is no al-Qaeda around here,” exclaim Tutkai's incensed elders. To their mind, the Pakistanis are sitting on Afghan land. The elders sent 600 men to clear the Pakistanis out. Several pathetically-armed villagers were killed in a resulting exchange of fire. The Pakistanis have their own injured, too, according to an Afghan commander.

There is dissimulation among the tribesmen. Many assert themselves to be in Afghanistan while having their roads and schools paid for by Pakistan. Even so, the Pakistani advance seems designed to provoke the Afghans into battle and to incite nationalist populism, which has led to the ransacking of the Pakistani embassy in Kabul by a mob.

But why? To divide the Pushtuns, or increase the Pakistani cut in smuggling, say hotheads. Water, however, is a more likely reason. About a fifth of the world's opium is grown in Nangarhar. International projects to eradicate the crop will rely on damming the mighty Kabul and Konar rivers for irrigation and electricity. That means less water—and possible trouble—downstream for parched Pakistan. Destabilising Nangarhar, goes the theory, would put off the dam building.

There is also the murky question of American involvement. Special forces appeared briefly in the disputed area but left soon after the Pakistani advance. The hunt for Osama bin Laden is one thing, perhaps; preserving the stability of Afghanistan, another.

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North Korea

Blame game

Jul 17th 2003
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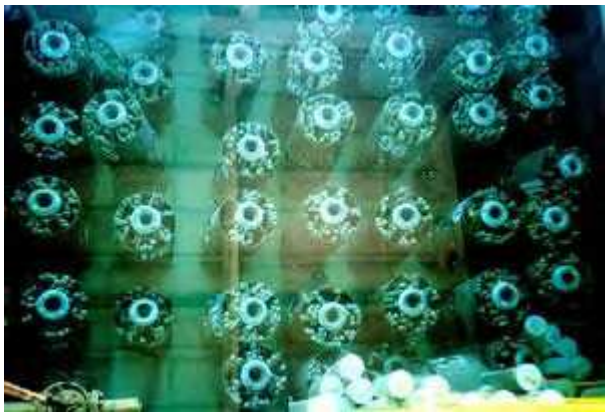
Peace or war on the Korean peninsula

AP



Ready for reprocessing

IN THEORY, everyone involved wants peace and stability on a nuclear-weapons-free Korean peninsula, and is ready for talks to bring about this happy result. Yet in a week when China's efforts to convene a second round of multilateral talks, as a framework for resolving the stand-off over North Korea's nuclear ambitions, revived hopes of a diplomatic breakthrough, William Perry, a widely respected former American defence secretary, was predicting that there could be war over the issue before the year was out. Not just either, but both, of these forecasts could be true.

Since it owned up, last October, to starting a project to enrich uranium, in direct breach not only of the Nuclear Non-Proliferation Treaty, but also of a 1994 agreement with the United States that froze an earlier plutonium programme in return for energy assistance and of a non-nuclear agreement with South Korea, North Korea has also told American officials that it already has a couple of nuclear weapons and is busy making more. Last week it reportedly said that on June 30th it had finished reprocessing the 8,000 spent fuel-rods that had been put in storage under the 1994 agreement. If that claim is true, the plutonium extracted would be enough to build another five or six nuclear warheads in a matter of months, enough to test one just to prove it has such weapons and still have enough left over to use or sell—which is Mr Perry's chief concern.

Just bluffing? America has recently detected tell-tale emissions of krypton gas from North Korea's reprocessing plant at Yongbyon, but in smallish amounts. American and South Korean officials think that possibly only a small number of fuel-rods have been reprocessed so far. North Korea, they believe, may be trying to pile on the pressure to try to win the bilateral talks with America it has been demanding, before going ahead with another round of multilateral ones that America insists on. Claiming that the reprocessing is done may also be a way of deterring an American strike, since the plutonium, once extracted, could be moved anywhere.

There is concern, too, that North Korea could soon put nuclear tips on its missiles aimed at Japan and beyond. Recent explosive tests of the non-nuclear triggers needed for building more nuclear weapons are thought to be part of an effort to adapt designs for missile-mountable warheads to use plutonium. The designs themselves, suggests Gary Samore of the International Institute for Strategic Studies in London, may, like the North's uranium-enrichment technology, have come originally from Pakistan, whose uranium-based warheads are already fitted on North Korean Nodong rockets as part of Pakistan's nuclear force.

So far, the Bush administration has threatened North Korea, not with war, but with further isolation—including, with help from other countries, the interdiction of shipments of the missiles and illegal drugs that finance its nuclear habit and growing pressure to suspend construction of two civilian nuclear reactors that were part of the 1994 deal—although George Bush has been careful not to rule out force. But China is growing increasingly anxious, both at North Korea's brinkmanship (before the 1994 deal the previous Clinton administration had considered reprocessing of spent fuel as justification for a military strike), and at America's firm insistence that North Korea dismantle its illicit weapons programmes before relations can improve. China's president, Hu Jintao, this week sent a compromise proposal to the North Korean leader, Kim Jong Il: a multilateral format, possibly eventually including South Korea and Japan too, that would also allow for bilateral exchanges.

But is either side really interested in a deal or simply trying to avoid taking the blame if talks fall through? The Bush administration has been divided over whether to discuss seriously with North Korea how and under what conditions its weapons programmes might be dismantled or to tighten its isolation in the hope that the regime there will collapse. Frustration over such dithering probably prompted Mr Perry's outburst.

Nor is it clear whether North Korea really wants a deal or really wants a nuclear deterrent. Even if it were to negotiate in better faith this time, would it accept the intrusive inspections needed for a deal to stick? It has refused them in the past. The prospects for peace and stability, in truth, still look decidedly gloomy.

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Hong Kong

Desperate remedies

Jul 17th 2003
From The Economist print edition

Will Tung Chee-hwa be next to go?

Get article background

SHORTLY before he took office as Hong Kong's first post-colonial leader, six years ago, Tung Chee-hwa recalled his experience of protest movements in the United States in the 1960s. “I certainly don't want to see this happen” in Hong Kong, he said. Now his fears are coming true. Since the beginning of the month, three members of his cabinet have resigned—two of them just this week—amid an upsurge of anti-government protest on the streets and demands for greater democracy.

China's top representative in Hong Kong, Gao Siren, bravely insisted this week that the territory was “a city of business, not of politics.” But Mr Tung is now embroiled in a deepening political crisis. On July 16th, he announced the resignation of his secretary for security, Regina Ip, the woman who had spearheaded the government's efforts to introduce a new internal-security law. Her uncompromising stance on the bill helped attract half a million people onto the streets on July 1st for the biggest public demonstration of Mr Tung's rule. Just hours later, the finance secretary, Antony Leung, stepped down too.

No specific reasons have been given for their decisions to quit. Officials claim Mrs Ip actually submitted her resignation for unspecified “personal reasons” a week before the July 1st protest. But few in Hong Kong will believe it was coincidental that the two happened to be the cabinet members whose removal had been most frequently demanded by pro-democracy protesters in recent days (apart, that is, from the ouster of Mr Tung himself). Pressure on Mr Tung was sustained by two further protests—not nearly as large as the one on July 1st but still involving tens of thousands of people. The latest, on July 13th, called for full democracy in Hong Kong.

Mr Leung had aroused controversy by buying a luxury car shortly before announcing a new vehicle tax in his budget speech in March. The affair was widely seen as a test of Mr Tung's new “ministerial” system of government introduced last year. This involved putting political appointees in charge of key departments, rather than civil servants. The supposed aim was to increase the accountability, and so the legitmacy, of policymakers. But Hong Kong's part-elected legislature had no power to remove an errant “minister”, and many in Hong Kong saw Mr Tung's failure to sack Mr Leung as soon as the scandal became known as confirmation that the system would actually do neither.

After her resignation was announced, Mrs Ip issued a statement defending her stance on the internal-security bill. “We have tried our best to strike a balance between protecting national security and safeguarding Hong Kong people's rights and freedoms,” it said. But in response to the July 1st protest, Mr Tung had announced plans to water down the bill. The resignation of another cabinet member, James Tien, on July 6th forced Mr Tung to delay its submission for final approval by the legislature. Mr Tien heads a normally pro-government party whose support for the bill was essential to its passage.

Mr Tung is now heading for Beijing to brief Chinese leaders on developments in the territory. He will find a deeply anxious audience. On Monday the China Daily, a state-controlled newspaper, said in its Hong Kong edition that the recent three demonstrations were “a vehicle for subverting the political system in Hong Kong.” It accused pro-democracy organisers of tricking people into taking part.

Such words on the Chinese mainland would often be a prelude to a crackdown. Mr Tung will need to work hard to convince Chinese leaders to stay cool. His authority has not only been crippled by events in Hong Kong, but is seriously doubted by Chinese officials too. The odds on his own ejection are shortening.

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India

All yours

Jul 17th 2003 | DELHI
From The Economist print edition

More freedom for privatised companies

AFP

Buy the car, buy the company

WITH a general election due in India next year, any proposed economic reforms likely to prove controversial are being curtailed. But Arun Shourie, the minister for disinvestment (that is, privatisation), has found a way to revive a corner of his largely-stalled programme. Since Mr Shourie, a former World Bank economist, took on the job in 2000, 13 state-owned companies have been sold off. His aim now is gradually to free privatised businesses from continued interference by ministries that retained minority, but not insignificant, stakes of around 26-35% when control was sold to private-sector buyers over the past couple of years.

Civil servants and ministers, who have been loth to see their often lucrative power erode in corporations that were once state-owned, are now to be eased out. The government plans to sell its residual stakes in five businesses, including 26% in VSNL, a telecoms and internet corporation now controlled by the Tata group, and 34% in IPCL, a petrochemicals company bought by Reliance. Starting in the next few months, the stakes will either be sold to the new owners, such as Tata and Reliance, India's largest private sector companies, or floated on the stock market.

Mr Shourie's confidence in the appetite for the sales stems from the government's successful disposal last month of a 27.5% stake in Maruti, India's largest car maker, whose joint venture with Suzuki spearheaded the modernisation of India's car industry 20 years ago. Suzuki bought a controlling stake last year, reducing the government's holding to 45.5%. Last month's sale brought that down to 18.3%, which is likely to be sold later. It was one of India's most successful public offerings, more than ten times over-subscribed, with bids from over 300,000 investors. The stock trades at 40% above its issue price.

That sale has helped to revive the Mumbai (Bombay) stock market, which has been buoyed by other good news. Forecasts from policy institutes suggest that the economy will grow by 6% or more this year, compared with projections of around 5.5%, pulled up from 4.4% last year by the present strong monsoon and some recovery in manufacturing industry. But the government's present refusal to pursue unpopular economic reforms means that this figure may not be sustainable.

A revival of the reforms cannot be expected until after the general election which, some pundits are forecasting, might be brought forward from autumn next year, the due date, to as early as February. A buoyant economy may encourage the Bharatiya Janata Party (BJP), which leads the ruling coalition, to risk this dash for hoped-for victory. The party will not decide until the results are in for elections to four key states' assemblies, due towards the end of this year. If they go well for the BJP, early national polls might follow.

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The Philippines

Open prison

Jul 17th 2003 | MANILA
From The Economist print edition

A suspected terrorist walks free

Get article background

THE most important suspect captured in the Philippines since it joined the American-led war on terrorism vanished from his cell in the national police headquarters in Manila on July 14th. The escape of Fathur Rohman al-Ghozi, an Indonesian accused of belonging to Jemaah Islamiah (JI), an alleged terrorist group, was another blow to the Philippines' battered reputation for reliability in the fight against terrorism.

Mr al-Ghozi added to the embarrassment of President Gloria Arroyo's government by escaping on the day that the Australian prime minister, John Howard, began a visit to Manila, during which he announced A$5m ($3.25m) in aid for the Philippines' counter-terrorism efforts. Mr al-Ghozi was arrested in Manila last year. A court imprisoned him for 17 years for illegal possession of one tonne of explosives, said to be meant for attacks by JI on western targets in Singapore. It was claimed that he was involved in bombings in Manila in 2000 that killed 22 people.

If the loss of such an important suspect was bad for the Philippines' reputation, the manner of his escape was worse. Mr al-Ghozi's cell in Camp Crame, the sprawling headquarters of the national police, was found empty on the morning of Mr Howard's arrival. Also missing from their cells were two prisoners accused of belonging to Abu Sayyaf, a gang of Filipino Muslim kidnappers which, like JI, is said to have connections with al-Qaeda.

The national chief of police speculated that someone had been bribed to allow the prisoners to escape. The Philippines has had difficulty keeping hold of its prisoners. Last year the leader of the Pentagon Gang, another group of Filipino Muslim kidnappers whom the government regards as terrorists, escaped from Camp Crame. He was later killed in what the police say was a gunfight near Manila. In 1995, Khaddafy Janjalani escaped from police headquarters, and became chief of the main faction of Abu Sayyaf.

President Arroyo tried to repair the damage caused by Mr al-Ghozi's escape. A reward of 5m pesos ($93,000) was offered for his recapture. But the Australians must be wondering whether their investment in the Philippines' campaign against terrorism is money well spent. So must the Americans, who are pouring tens of millions of dollars into Mrs Arroyo's counter-terrorism effort.

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Arab democratic reform

Arab reform, or Arab performance?

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From The Economist print edition

Most regimes have made gestures of a sort, but they don't add up to much as yet

WHEN America invaded Iraq, its ambitions went beyond ousting Saddam Hussein. Many in George Bush's administration hoped that the fall of the cruellest regime in a bad neighbourhood would inspire reform elsewhere. Has this happened? The short answer is no. A longer answer is that there are inklings of change, but they started before the Iraqi war and will be slow to bear fruit. Moreover, some of that fruit may prove bitter to America.

Three months is a short time to expect results of the kind that Mr Bush prophesied in February. A new regime in Iraq, he said then, would bring “hope and progress” to the wider region, and serve as a “dramatic and inspiring example of freedom.” America's underlying rationale was that Arab dictatorships fostered dangerous radicalism by denying young Muslims normal outlets for expression. Iraq was to be the first stage in draining these swamps.

America's blunt intervention added urgency to an already heated local debate on why Arab political systems have, almost universally, failed to generate accountable, clean or competent government. Public forums, from call-in television shows to provincial cafés, are ablaze with disparagement of the status quo. One often noted point is that the sole government in the region to have respected its people's wishes by trying to hinder America's invasion of Iraq was Turkey, which happens, with Israel, to be the region's fullest democracy. At last month's World Economic Forum meeting in Jordan, well-heeled Arab participants roundly dismissed the once-popular notion that economic liberalisation is a necessary precursor to political reform.

Are governments bending to the wind of foreign and domestic criticism? Syria, for instance, claims to have embarked on a programme of voluntary de-Baathification. The country has for three decades been ruled by a milder, but still oppressive, version of Saddam Hussein's party. Now, according to a recent government decree, the party will cease all its interference in policymaking and administration. Officials, the decree says, will be promoted on the basis of merit, not party affiliation.

Cynics, and there are plenty of them in Syria, dismiss the resolution as one of a series of gestures to pre-empt pressure from America, pressure that has been intensified by the uncomfortable proximity of American forces in Iraq. Even so, the move could also be a belated acknowledgement of the need to break out of Syria's crippling political and economic stagnation.

It might even have been an indirect response to a petition, signed by 300 Syrian intellectuals in May, calling for “comprehensive national reform”, including the release of political prisoners and freedom of opinion and assembly. It is significant, however, that the point of these demands was not so much to attain better government, but rather to strengthen Syrian society the better to resist American hegemony. In other words, America's presence in Iraq has succeeded in emboldening Syria's would-be reformers, more because it is seen as a threat than as a promise.

Saudi Arabia's very different, but similarly stifling, autocracy has also met a growing barrage of reformist petitions with signs of unusual openness. For the first time it is not only liberals who are demanding change, but also mainstream religious figures, including some from the long-silenced Shia minority.

Crown Prince Abdullah, the country's acting ruler, was last month host to a forum of intellectuals who produced a broad blueprint for reform. Again, however, the government has made clear that its understanding of the purpose of debate was less to gauge and accommodate popular demands than to “strengthen national unity” in the face of harsh criticism from abroad, especially from America.

A bitter election message

Other countries in the region have forestalled American ire by keeping up better democratic appearances. Jordan and Kuwait, for instance, recently held relatively free parliamentary elections. But both polls were marred by gerrymandering that allows rulers to pack their weak legislatures with what are known as “service deputies”: MPs who run on their ability to give jobs and perks to fellow tribesmen.

Kuwait's election on July 5th delivered a further blow to hopes of reform. Relief at the fall of Saddam Hussein, and Kuwaitis' positive attitude to the heavy American military presence in the emirate, failed to translate into support for the American agenda of privatisation, opening the door to foreign investment, de-Islamised education and women's rights. Islamist and tribal candidates ousted liberals from all but three of parliament's 50 seats. “Our people have spoken; they have rejected all attempts to westernise our society,” trumpeted Walid Tabtabai, an Islamist deputy.

Many governments have long used fear of the Islamists as an excuse for limiting freedoms. Such is the case across North Africa, where rulers have happily made use of their western supporters' post-September 11th concern with terrorism to oppress their citizens. Yet the old assurance that America would rather have stability than risk empowering radicals is weakening.

Across the region, including Iraq, the Islamist trend remains the one most likely to succeed in open elections. But such elections are not yet in sight. Perhaps, as Kamal Abul Magd, a former Egyptian minister with mild Islamist leanings, suggests, Arab regimes are simply too addicted to power. They can make the right gestures, but even a small relinquishment of authority produces ugly withdrawal symptoms. “I know this from my experience as a public prosecutor,” says Mr Abul Magd. “Because of the nature of your job, you start treating everyone like a criminal.”

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Jordan's secret service

The fall of a kingmaker

Jul 17th 2003 | AMMAN
From The Economist print edition

The whispers behind a secret-service corruption trial

Get article background

IN AN Arab world ruled by secret services, retiring intelligence chiefs are either honoured or, fairly literally, axed from office. So champions of reform and accountability may have welcomed Jordan's decision to put its former intelligence chief, Samih Battikhi, on trial for abusing his job to get rich.

But, despite the king's promise of transparency, Mr Battikhi, once the country's most powerful man, was condemned last week to four years in jail after a trial behind the closed doors of Jordan's secret police headquarters, with a secret agent for judge. For witnesses, the prosecution relied mainly on the confessions of Majd Shamayleh, the prime suspect in one of Jordan's largest banking scandals.

Prosecutors claimed that Mr Battikhi helped Mr Shamayleh, an IT salesman, to raise $1 billion in loans to upgrade the secret police's computers. Much of the money went astray, including, says the prosecution, $24m that Mr Battikhi took for himself. Mr Battikhi protests his innocence, says he never met Mr Shamayleh, and that the charges were trumped up to end his career.

Four years ago, when King Hussein lay on his American death-bed, Mr Battikhi, in effect, ran the kingdom. Colleagues dubbed him the kingmaker when he removed Hussein's patient brother, Hassan, from the succession, and put Abdullah, the king's son, on the throne instead.

But then, say the king's friends, he became hungry for reward. Not content with being intelligence chief, he aspired to such titles as prime minister or chief of the royal court. King Abdullah, not caring for this, booted him gently upstairs to the Senate. But he continued to talk, not least, it is said, to such friends as George Tenet, the CIA chief.

Former royal courtiers say he blabbed to the Americans about the smuggling of Iraqi oil, allowed for Jordan's domestic consumption, to Egypt. In his last interview before his conviction, he accused senior politicians of being on the Iraqi regime's payroll. Jordan, he charged, had been taking money and praise from America while passing militarily sensitive technology and intelligence to Saddam: when Mr Battikhi protested, he says, he was dumped.

American-Jordanian goodwill has, so far, survived his downfall.“We are the *soupe du jour* of the United States,” remarked the king's uncle, Hassan, this month in London. “But the *soupe du jour* has a way of cooling.” Maybe the old-fashioned Arab ways of disposing of unwanted courtiers are safer after all.

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Burundi's broken ceasefire

Living in fear

Jul 17th 2003 | BUJUMBURA
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Tribal battles for meagre resources

AS THE shelling began, rebels ran through the streets of Kanyosha, a neighbourhood in Burundi's capital, urging residents to flee. Simultaneously, soldiers from the regular army started banging on doors, demanding that everyone move out, lest they be deemed rebels and shot. Then, the two sides started to kill each other. Burundi's ceasefire may have failed, but at least the combatants are taking a little more care not to harm civilians. For Burundi, that is progress, of a sort.

Yet the fighting around Bujumbura this week was the worst for years. At least 170 people were killed and 12,000 forced to flee their homes. Soldiers helped themselves to residents' ducks, chickens and other foodstuffs. Artillery showered on the town centre. Corpses, some of child soldiers, were left rotting for days on the streets. Eventually, a measure of calm returned, as did many of those who had abandoned their homes. But Kanyosha and other suburbs still teem with soldiers, each with three or four clips of ammunition taped to his grubby Kalashnikov, in anticipation of another round of fighting.

If Burundi's war was ever motivated primarily by ethnic hatred, that day is long past. It started in 1993, after the country's first Hutu president was assassinated by renegade Tutsi soldiers. Tribal massacres followed, but the conflict has since then morphed into a struggle for power, and so for control over Burundi's ridiculously meagre resources. Some of the worst acts of brutality have been committed by Hutus against other Hutus: the mainly Hutu rebels are now fighting a government that is headed by a Hutu.

Shortly before Christmas, with South African mediation, the government reached a ceasefire agreement with the main Hutu rebel group, the Forces for the Defence of Democracy (FDD). Then, on April 30th, under the terms of an earlier accord, the Tutsi president, Pierre Buyoya, stepped down in favour of his Hutu deputy, Domitien Ndayizeye. Sadly, the FDD has not honoured the ceasefire, and a second, more extreme Hutu rebel group, the Forces of National Liberation (FNL), refuses to negotiate with the government at all. Its leader, Agathon Rwasa, would apparently prefer to cut a deal directly with the Tutsi-dominated army.

The current offensive may have enjoyed support from the FDD, though the group vigorously denies it. The FDD is thought to want to eliminate Mr Ndayizeye's party, Frodebu. That would leave it as the main Hutu political force. Dozens of Frodebu provincial officials have been assassinated in recent months.

But the latest violence may have galvanized outsiders to take a tougher line with those responsible. South Africa's deputy president, Jacob Zuma, breezed through Bujumbura this week to lend support to Mr Ndayizeye, who most foreigners consider to be a force for peace. Uganda's president, Yoweri Museveni, muttered darkly about imposing a “military solution” on Burundi. On July 20th, various Burundian groups are to meet for a summit, with neighbouring governments, in Tanzania.

A year ago, say UN officials, 11 of Burundi's 17 provinces were peaceful enough to start receiving development aid, not just emergency supplies of food and medicine. Today, only a single, remote north-eastern region is calm. Everywhere else, civilians live in daily fear of indiscriminate rebel attacks, and the shells the army lobs into the hills to retaliate.

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South Africa and AIDS

Fight over the thinning disease

Jul 17th 2003 | JOHANNESBURG
From The Economist print edition

A crisis crying out for leadership

Get article background

EPA

A comedian signs autographs for his fans

A “PEACEFUL virus”, is how Colonel Muammar Qaddafi described HIV to the African Union this week. Along with malaria and sleeping sickness, the Libyan leader said, it is God's way of keeping white colonisers out of Africa. That raised a laugh. Other African leaders take the awful threat of AIDS more seriously. But not as seriously as they should, particularly in South Africa. By the government's own estimate, 1.7m deaths could be prevented by 2010 if all who need anti-AIDS drugs could get them. But the only reason we know this is that the study containing this estimate, which was finished in April but not published, was leaked this week.

Using cheap generic drugs, the report's authors estimated the cost, including doctors' time, would be at most 21 billion rand ($2.6 billion) over the next seven years. This is a big sum for a middle-income country, but affordable, easily so if the government could bring itself to accept some of the money that the UN-sponsored Global Fund keeps offering it.

Officials talk blithely of acting with the “utmost urgency”, but the report's findings have not even been discussed by the cabinet, which has met only once in three months. This fits a pattern. Figures that show infection rates worsening among pregnant women have not been published. And for the past 18 months, President Thabo Mbeki has stymied a plan to allow universal access to anti-AIDS drugs, though money is already earmarked.

What explains this reluctance to act? In part, Mr Mbeki's scepticism about the safety and usefulness of anti-retroviral drugs. His health minister calls them “poisons”. Another reason is that many South Africans are suspicious of western drug firms, who they fear want only to profit from sick Africans.

Meanwhile, a World Bank study gives warning of a “complete economic collapse” in South Africa if there is no effective response to AIDS. That is probably an exaggeration, but most economists agree that the disease hampers growth, so the cost of not treating it may be higher than doing so (see article). A number of South African firms give drugs to infected workers because, they say, it saves money in the long run. The government may finally be coming round to this view. An adviser to Mr Mbeki says the cabinet will review the leaked report “within weeks”. The delay, it is said, was to “ensure that cabinet is ready to take a decision.”

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A coup in São Tomé

Troubled waters over oil

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Oil curses another African state

THE people of São Tomé e Príncipe have talked of little else for months. Several billion barrels of oil lie around their tiny islands, they say, and this will change everything. This week, it did. Early on the morning of July 16th, in a brief burst of gunfire and grenade explosions, a major called Fernando Pereira took over the radio and television station, rounded up the prime minister and her cabinet, and declared himself army commander. São Tomé's president, Fradique de Menezes, escaped arrest because he was in Nigeria at the time, talking about a recent deal he had signed to explore for oil on the countries' shared maritime border. Nigeria condemned the coup, and demanded its reversal. An aide to the chairman of the African Union said that military intervention was an option.

Who are the coup leaders, who is backing them, and what do they want? On television, a rebel spokesman announced the creation of a “junta of national salvation” to reverse the country's “decline”, but no one is quite sure what this means.

Members of a shadowy local group called the Frente Democrata Cristã (FDC) have apparently been spotted among the coup plotters. This may be significant. Some FDC members took part in an unsuccessful invasion in 1988, from bases in Gabon, where they were in exile. Some are thought to have been trained by South African apartheid-era soldiers. The group seemed to hibernate for the past decade or so, but reappeared last month, and began organising demonstrations, accusing the government of corruption, and urging the prime minister and the executive to resign.

Whoever is behind it, everyone assumes that the (apparently bloodless) coup must have something to do with oil. São Tomé is small and poor. Only 150,000 people live there, and its biggest “export” for now is diplomatic recognition for Taiwan, which typically donates $30m a year in aid. Aside from that, it sells about $4m worth of cocoa each year, welcomes a few Portuguese tourists, and makes a bit from international telephone sex lines. In October, however, São Tomé will start auctioning the rights to look for oil under nine blocks of its territorial waters. Oil firms could bid $30m or more for each block.

Suddenly, the country is getting a lot of attention. America, jittery about Arab politics, is keen to see more exploration in this part of Africa, a straight sail from its East Coast refineries. Speculation that America could set up a military base on São Tomé has been denied on all sides, but several white men with short haircuts and American accents have been spotted in town in the past year.

Other African states with oil have usually been corrupted by it: Nigeria, Equatorial Guinea, Angola, Congo-Brazzaville and Gabon, for example. In São Tomé, everyone wants a piece of a pie that has not yet been baked. The army has been grumbling about the need for higher pay. Mr de Menezes, a former cocoa tycoon who took office in 2001 after an election campaign he admits was financed by foreign oil money, has been squabbling with parliament over who should control the oil sector. Last year, he accused unnamed oil interests of trying to “destabilise” him.

The president has battled to renegotiate contracts signed with Exxon Mobil and a Nigerian-owned company called Chrome, which the IMF said were unfair to São Tomé. But the latest renegotiation prompted a series of public statements by several senior members of the political class, who said the deals were rotten, and too generous to foreigners.

Local politics in São Tomé is complicated because anyone who is anyone knows everyone else, and politicians tend to be related to each other. Political life has mostly been peaceful since independence from Portugal in 1975; conflicts have often been resolved through family mechanisms. But not, it seems, any more. “The crazy part of all of this,” says Alex Vines, head of the Africa programme at the Royal

Institute of International Affairs in London, is that no one has actually found any oil yet in São Tomé. “People are basing all this on seismic data alone.”

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Europe's stability and growth pact

Loosening those bonds

Jul 17th 2003 | BRUSSELS
From The Economist print edition

Europe's governments are wriggling free of the stability pact's constraints

WATCHING the governments of the euro zone dealing with its stability and growth pact is a little like watching an escapologist struggling free from a tight knot of rope. With each successive move, there is a growing sense that it is only a matter of time before they break loose.

The rules of the pact are exceptionally complex, but the principles are simple. In normal times all members of the European Union are meant to aim for budgets that are “close to balance or in surplus”. Governments that run fiscal deficits bigger than 3% of GDP must take swift corrective action. And if any of the 12 countries that have adopted the euro breach the 3% limit for more than three years in a row, they may be liable to fines of billions of euros.

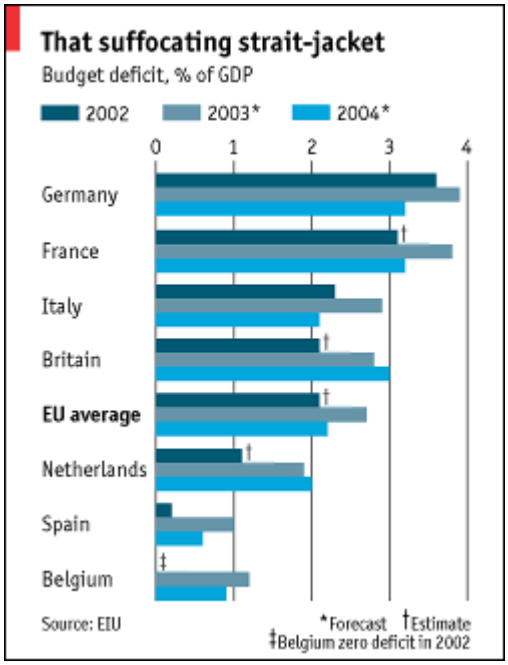
These provisions were meant to be so intimidating that no government would dare breach the 3% rule. It has not worked out like that. Last year France, Germany and Portugal all broke it; and France and Germany are certain to do so this year again. This week Francis Mer, the French finance minister, told his European colleagues that France was likely to break 3% next year too. The Germans still claim they will be below 3% in 2004, but their growth projections look rather optimistic.

European officials and politicians see a train crash coming and are starting to take evasive action. This week Jacques Chirac, France's president, called for the pact's “temporary softening”. A group convened by Romano Prodi, the European Commission's president, has also just called for a modification of the conditions under which the 3% line may be breached.

But the pact's defenders are not giving up. The Austrian, Irish and Dutch finance ministers have all called for the letter of the stability pact to be observed and they have supporters in the European Central Bank and in parts of the commission as well. The diehards fear that if the pact is indeed modified, then all attempts to impose fiscal discipline in the euro area will be imperilled. The consequence, they fear, would be a surge in government deficits and bitter political recrimination.

Although some of the pact's defenders acknowledge privately that it is highly unlikely that EU governments will ever really vote to impose those fines of billions of euros on Germany or France, they

believe there is an earlier line of defence. Next year the EU's finance ministers could vote to impose binding recommendations on countries that have persistently breached the 3% limit. The hope, probably misplaced, is that Germany and France would then impose the necessary austerity measures.



But would that make economic sense? Japan in the 1990s and the United States now have reacted to slow growth by ramping up their budget deficits. The OECD is forecasting that this year America's deficit may hit 4.6% of GDP and the Japanese one may still be as high as 7.7%. Many economists agree that it makes little sense to force European governments whose countries' economies are nearly in recession to slash public spending.

So how could the pact best be modified? Several ideas are doing the rounds. One is to exempt certain types of government spending, for instance, on research and defence, from deficit calculations. But this is casuistry: spending is spending. Another idea is to widen the 3% limit—perhaps to 5%. Alternatively, the conditions under which a breach of the 3% rule is allowed could be changed. Rather than being an inflexible barrier, it might be adjusted according to the economic cycle.

Perhaps the best option would be to concentrate on levels of government debt rather than on annual deficits. A breach of the 3% limit is a more serious matter in a country like Italy, which still has government debts of over 100% of GDP, than in Germany or France, where the national debt is relatively well under control.

All these would-be solutions, however, raise problems of their own. The current rules are written into European law. Getting agreement to change them would require the consent of most EU governments. But those countries that have been virtuous over deficits will be reluctant to give leeway to the malefactors.

Meanwhile, economists at the European Commission worry that, if governments cannot control state spending in present circumstances, they will face an explosion of deficit spending in decades to come, as pensions costs soar (see article). Ultimately, that could threaten the very viability of the euro. Such concerns are entirely fair. But the answer is for governments like those of France and Germany to get serious about structural and pension reform. Forcing their economies into recession through an austerity drive now will do nothing to solve the euro zone's long-term problems.

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Germany's capital

Nearly bust

Jul 17th 2003 | BERLIN
From The Economist print edition

Will the federal government bail out the capital?

PROUD capital of the world's third-richest country, the city-state of Berlin is sinking ever deeper into a financial mire. Its debts, already *euro*53 billion ($60 billion) for a population of just 3.4m, are out of control. Unemployment, at 18%, is at its highest since unification. Since the generous federal subsidies that used to be poured into West Berlin were phased out in the mid-1990s, the city's economy has shrunk by nearly 6% while the national economy has grown by 10%. Its dwindling tax revenues now barely cover a third of its outlay. Unless the federal government is willing to bail it out again, it will go bust, say the city's politicians.

With the economic downturn, nearly all Germany's 16 *Länder* (states), are feeling the pinch. But Berlin is in deeper trouble than any other. It is not as if its authorities have not tried. Since the collapse of a Christian Democrat-led city government two years ago, the ruling “red-red” coalition of Social Democrats and ex-communists has hacked back public spending more ruthlessly and pushed through more radical and painful financial reforms than any other state—despite massive protests.

University funding has been slashed, tuition fees brought in for long-term students, subsidies for housing abolished, urban renewal projects abandoned, charges introduced for school books, kindergarten fees jacked up, 1,450 police jobs axed, swimming pools closed, grants for welfare recipients ended, fountains turned off, arts funding chopped, a freeze imposed on civil-service vacancies, and plans to lop *euro*1 billion off the city's wage bill of *euro*7 billion by 2006 have been approved.

Earlier this month, the city reached a milestone agreement with the trade unions to cut the pay of 70,000 city employees by an average of 10% in return for shorter working hours and a pledge of no compulsory layoffs before 2009. Another 70,000 with *BEAMTE* (permanent civil servant) status will have their holiday bonuses scrapped and their Christmas bonus, equal to 86% of their monthly pay, replaced by a flat-rate payment of *euro*640.

But all this is still not enough. The city now hopes to balance its books by 2006—excluding service payments on its debt. The interest alone amounts this year to *euro*2.4 billion, or 11% of the city's total budget, which, it says, is more than it can afford. It wants the federal government either to relieve it of a large hunk of its debt (*euro*35 billion of it, with luck) or to take over the whole of its interest payments. But the federal government, itself pushed for cash, has refused to help. So the city is to lodge an appeal with the Constitutional Court in September. A ruling is not expected before 2005—with no cash likely for another year or so after that.

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The French exception

Still defended

Jul 17th 2003 | PARIS
From The Economist print edition

Why it is hard for French governments to fight against performing artists

EPA

Exceptionally hard-working comedian

WHEN Jean-Marie Messier, the ousted former head of Vivendi Universal, declared in 2001 that the “French cultural exception is dead”, it marked the day the French establishment turned on him. The media mogul, who turned a French water-utility company into a Hollywood-to-mobile-phones conglomerate, had touched too raw a nerve. In France, the idea that culture is precious and fragile and so needs careful protection goes unchallenged. So why does President Jacques Chirac now appear to be undoing a critical element of the French cultural exception by facing down striking theatre workers?

The strikes by part-time theatrical performers and back-stage technicians have led to the cancellation of many summer festivals, including the two biggest, in Avignon and Aix-en-Provence. As Bernard Faivre d'Arcier, director of the Avignon one, points out, this event was not cancelled even in 1968. “A unique cultural movement is now in question,” says Jack Lang, a Socialist former culture minister.

The artists' complaint is about proposed changes to their unemployment regime, which currently entitles them to 12 months of benefits for working 507 hours (little more than three months' worth for most workers) a year. Over the past decade, the number of such part-timers has doubled, thanks to the proliferation of state-supported performers as well as to benefit fraud by television and show-business companies. Jean-Pierre Raffarin, the prime minister, may not look too concerned about cutting public spending, but he knows that reform is needed, as he has demonstrated over pensions.

However, these two rival aspirations—to curb public spending and to appear to uphold the French cultural exception—conflict. Mr Raffarin may be from the centre-right, which is far less tolerant of state support for clowns or fringe theatre. But he is fully aware that France's cultural policy has both popular support and a long tradition. In February, Mr Chirac explained it thus: “The artist gives to life, as to the world, flavour, sense and beauty. Mirror to mankind, he decodes his soul. Witness to his history, he embodies his revolt against the absurdities of his time, his quest for a better world.”

Contrast that with a recent comment by Britain's culture minister, Tessa Jowell: “The UK has some of the most talented and exciting artists and sports stars and vibrant creative and leisure industries in the world. They contribute massively to our economy and prosperity.” In sum, French culture nourishes the soul, while Britain's contributes to its export earnings.

But could the current conflict with the artists not perhaps help the government? France has just managed to keep a cultural veto in the draft of a constitution for Europe—“a very great victory”, said Mr Chirac this week. It wants to defend the “cultural exception” in the upcoming talks on liberalising world trade. And it now faces an upswelling of complaint: this week, 650 artists, including Bertrand Tavernier, a film director, and Gérard Depardieu, an actor, wrote to Mr Chirac bemoaning the attack on state support for culture. In the face of such domestic protest, the French government can hardly be expected to make too many compromises abroad.

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Montenegro

Something rotten

Jul 17th 2003 | PODGORICA
From The Economist print edition

The prospects for Montenegro, whether independent or not, are bleak

Get article background

SERBS and Kosovo Albanians do not agree on much but these days a lot of them see eye to eye on one thing, at least. They will not be going on holiday to Montenegro anymore because they say it is too expensive and the service terrible. That is bad news for Montenegro, which relies on their business and in any case is finding that it is not just the next-door neighbours who don't love it these days. Its general reputation, in the Balkans and in the wider world, has sunk pretty low.

Ever since the fall of Serbia's strongman, Slobodan Milosevic, in October 2000, Montenegro, Serbia's only remaining partner in what was left of Yugoslavia, has found the going increasingly tough. When its former president and current prime minister, Milo Djukanovic, came out against Mr Milosevic in 1997, the West lavished aid on the tiny republic and overlooked its lucrative UN-sanctions-busting trade with Serbia, seeing it as a means of keeping the republic afloat. But those halcyon days of dodgy money-making with no questions asked are over.

While the assassination in March of Zoran Djindjic, Serbia's prime minister, laid bare Serbia's networks of organised crime, secret policemen and shady politicians, no such single traumatic event has overtaken Montenegro. But murky affairs have recently served to distract attention from reform. When its leaders meet their foreign counterparts, they are increasingly fed up with having to talk about cigarette smuggling and people trafficking rather than about pressing economic reforms.

But Montenegro's biggest scandal, which has convulsed the country since last November, concerns a woman from Moldova known only as “SC”, who claims that she fled from a Montenegrin brothel where she had been kept and abused, among others by top Montenegrin officials. The deputy state prosecutor was arrested on charges of involvement in sex trafficking. Officials admit that their country has been a conduit for traffickers but say they have taken robust measures to stop the trade. They also say that the Moldovan scandal has been manipulated, or even created, by the government's enemies. But last month's decision by the judiciary to drop the whole case has led to howls of protest, at home and abroad.

Spooking the duke

Alas for Mr Djukanovic's government, the Moldovan affair is not the only thing embarrassing it. Over the past two weeks the prime minister has been furiously denying allegations, aired among others by ANSA (Italy's main news agency) and by the media in Belgrade and Podgorica, the Serbian and Montenegrin capitals respectively, that he was involved in a smuggling operation connected to some dubious people in Naples. A former ally of his has also asserted in a Belgrade magazine that Mr Djukanovic used a Swiss bank account to salt away a large amount of money.

Before these allegations surfaced, Mr Djukanovic had been named last October in a lawsuit brought by the European Union against an American tobacco firm, R.J. Reynolds, over cigarette smuggling. The Montenegrin prime minister has also been under formal investigation for alleged involvement in smuggling by a prosecutor in the Italian town of Bari, just across the Adriatic Sea. But he and his allies say that these allegations are baseless and—along with the Moldovan affair—are all part of a conspiracy

to spike his plans to lead Montenegro to full independence.

After Mr Djukanovic fell out with Mr Milosevic, Montenegro operated as an independent country in all but name. It was only under fierce pressure from the EU that its government agreed last year to stay in a very loose “state union” with Serbia, at least for three years. In February this union came into being, consigning the name of Yugoslavia to the dustbin of history. Now Montenegro is painfully reintegrating—at least, a little bit—with Serbia. Harmonising customs and tariffs between the two has been tricky. Serbia, for example, exports food, while Montenegro imports it.

Those who favour independence, especially the current government, grouse that they have been forced into a wasteful and costly arrangement with Serbia against their will. They also point out, correctly, that one of the main reasons the EU brought so much pressure to bear on them to stay in some kind of union with Serbia was because of Kosovo.

Westerners trying to make policy for the region have sought to stall Montenegrin independence, fearing that it would provoke another crisis in Kosovo, now a UN protectorate, whose mainly ethnic-Albanian people want nothing less than independence. If 650,000 Montenegrins can have independence, then—the Kosovars would say—why can't 2m Kosovars too?

In any event, many Montenegrins are becoming angry. Their average month's pay is a paltry *euro*120 ($135), a third of them have no job, the government is poised to cut the bloated civil service, and industrial strife is growing. Critics charge that the government's cronies are trousering all the spoils of privatisation. Aid from abroad is drying up. For honest reformers, the choices are grim. If you dislike Mr Djukanovic's lot, but still revile the old pals of Mr Milosevic who make up the main opposition, where can you go?

Mr Djukanovic says it is only a matter of time before the world recognises Montenegro's independence. He may be right. Yet his own people are unsure. Recent opinion polls in Serbia suggest that 60% of Serbs now favour independence from Montenegro but pollsters have never found such strong support for independence in Montenegro itself.

Independent or not, Montenegrins have a lot of work to do—and very few people qualified to do it. No wonder some wag has sprayed, on a wall in Podgorica, “Vote for the Moldovan”.

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Russian conservation

Green tears over black gold

Jul 17th 2003 | LAKE BAIKAL
From The Economist print edition

Russia's natural jewel is at the mercy of oil money

“THEY do it because foreign governments pay them,” says Vyacheslav Maximov, a marine biologist living on the shore of Lake Baikal, of the environmentalists campaigning against pollution. “They're just interfering. You can't damage Baikal.”

As the world's biggest single body of fresh water, Baikal has always stirred passions. Its annual freezing and thawing drive thermal mixing all the way down to its bottom, 1,637 metres (5,371 feet) deep, bringing oxygen to a rich mix of plants and animals, keeping the lake water so clean you can drink it, and inspiring almost religious beliefs in its powers. Perhaps not everyone is as zealous as Mr Maximov, who stands on his head several times a day to replicate that mixing in his own body and is convinced that he will live for 200 years. But his distrust of outsiders, as the environmentalists tend to be, is widely shared.

Baikal Environmental Wave, led by Jenny Sutton, a British three-decade resident of nearby Irkutsk, argued against a pulp-and-paper mill that pumps effluent into the lake, damaging the environment nearby and, she says, killing some of the freshwater seals unique to Baikal. The security services raided her office, looking for “classified maps”; articles about “green spies” popped up in the local press.

But the mill is, at long last, being cleaned up. And scientists disagree about the long-term damage, thanks partly to the post-Soviet shortage of funding for the huge task of monitoring the lake. “There are some saying there's been an impact of pollution, and others that it's increased no more than the background level in other regions, like the Arctic,” says Anson Mackay, a Baikal researcher at University College, London. Many feel the lake is big enough to take the impact of letting the local economy grow, at least quite a bit.

But now there is a new threat. In April the government said it would let Yukos, an oil company, build a pipeline from the oilfields near Angarsk, said to be as big as Kuwait's, to Daqing in China. The pipeline

would curve around the southern end of Baikal, cutting across 59 of its tributaries. In a highly seismic region—141 years ago, 200 square kilometres (77 square miles) of lakeshore sank under water in an earthquake—that is risky.

Yukos's own impact study acknowledges that there is a “quite real” possibility of the pipeline rupturing and oil reaching the lake. Despite this, according to a critique of the study written by Rick Steiner, a conservation specialist at the University of Alaska, it includes no contingency plan for oil spills. But the pipeline would have to go through Mongolia to be outside the lake's watershed. And though Japan's government is urging Russia to take a more expensive route northwards and to Nakhodka, Russia's closest big port to Japan, this would run similar risks.

Baikal is listed as a “world heritage site” by UNESCO, and Russia has strong environmental laws, including a special one protecting the lake itself. But, says Greenpeace, the laws are frequently flouted: all the proposed versions of the China pipeline, for instance, run through national parks, which is supposedly illegal. It could be made fairly safe but environmental lobbying multiplied the cost of a pipeline across similar terrain in Alaska to nearly nine times the original estimate. Russia's greens do not have such clout.

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Lithuania

Baltic tiger

Jul 17th 2003 | VILNIUS
From The Economist print edition

Lithuania has the fastest-growing economy in Europe

NAME the country with the highest growth rate in Europe last year, booming exports, zero inflation, a rock-steady currency, shrinking unemployment and a budget surplus. Stumped by this happy conundrum? Then look to Lithuania, the southernmost of the three small Baltic states, and for most of the 1990s the quietest and sleepiest of them.

Sleepy no more, Lithuania romped home last year as Europe's top-performing economy with real growth of 6.7%. In the first quarter of this year it did even better, its economy swelling by 9.4%, year-on-year. The IMF thinks Lithuania will manage to grow this year by about 6% and the same again next year—a remarkable feat for a country that looked just four years ago as though it was veering towards tragedy rather than triumph in its transition away from communism.

The reforms paying off so handsomely now for Lithuania are the painful ones it took after its big neighbour, Russia, defaulted and devalued in 1998. The shockwaves from that crash hit all three Baltic countries, through their big Russia-related trade and finance activities. Lithuania, where reforms were slowest, was hit hardest. Its economy shrank by almost 4% in 1999 and local interest rates soared, as the government tried to finance a yawning budget deficit.

But Lithuania righted itself, with the IMF's help. It stepped up privatisations to raise quick cash, improved tax collection, and cut general government spending from 38% of GDP in 1999 to 32% in 2002. All this brought the budget deficit down from 8.5% of GDP in 1999 to just 1.2% last year—while this year's first quarter yielded a modest surplus.

Growth rebounded quickly. So did foreign investment, including a vital deal last year giving a Russian oil producer, Yukos, control of the Mazeikiu oil refinery, Lithuania's biggest export earner. The deal assures supplies of crude oil for Mazeikiu through the Soviet-era pipelines which tie it still to Russia.

Lithuania is being given a run for its money by its two Baltic neighbours. Latvia's economy grew by 6.1% last year; its rate in this year's first quarter rose to 8.8%. Estonia's grew by 5.8% last year; in this year's first quarter its rate was 5.2%.

But for all their dynamism, the Baltic trio still rank among the poorest of the ten countries due to join the European Union next year, with per capita incomes around one-fifth of the EU average. But with growth across the Union's current 15 countries averaging just 1% last year, the Baltic tigers are catching up.

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Charlemagne

Europe's population implosion

Jul 17th 2003
From The Economist print edition

Europe's population is shrinking and greying—with grim consequences

THE convention on Europe's future finally packed its bags last week in Brussels. At one of the many events to celebrate its achievements, Valéry Giscard d'Estaing, an elderly former president of France who has been chairing it, was asked to address an organisation called Friends of Europe. With unintentional irony, the event was held in the dinosaurs' hall of the Natural History museum in Brussels. The image of a 77-year-old man standing in front of a diplodocus was uncomfortably apt. The dramatic change in Europe's demographic profile will weigh far more heavily on the continent's future than the institutional minutiae that have been preoccupying the conventioneers.

Fertility rates across Europe are now so low that the continent's population is likely to drop markedly over the next 50 years. The UN, whose past population predictions have been fairly accurate, predicts that the world's population will increase from just over 6 billion in 2000 to 8.9 billion by 2050. During the same period, however, the population of the 27 countries that should be members of the EU by 2007 is predicted to fall by 6%, from 482m to 454m. For countries with particularly low fertility rates, the decline is dramatic. By 2050 the number of Italians may have fallen from 57.5m in 2000 to around 45m; Spain's population may droop from 40m to 37m. Germany, which currently has a population of around 80m, could find itself with just 25m inhabitants by the end of this century, according to recent projections by Deutsche Bank, which adds: “Even assuming (no doubt unrealistically high) annual immigration of 250,000, Germany's population would decline to about 50m by 2100.”

Combine a shrinking population with rising life expectancy, and the economic and political consequences are alarming. In Europe there are currently 35 people of pensionable age for every 100 people of working age. By 2050, on present demographic trends, there will be 75 pensioners for every 100 workers; in Spain and Italy the ratio of pensioners to workers is projected to be one-to-one. Since pensions in Germany, France and Italy are paid out of current tax revenue, the obvious implication is that taxes will have to soar to fund the pretty generous pensions that Europeans have got used to. The cost is already stretching government finances. Deutsche Bank calculates that average earners in Germany are already paying around 29% of their wages into the state pension pot, while the figure in Italy is close to 33%.

Governments are in a bind. It is no accident that in the past year France, Austria, Italy and Germany have all experienced angry outbreaks of labour unrest, sparked by attempts to make their pension systems less generous. But the longer governments wait, the worse the problem. Pension obligations will only get more onerous; and as voters age it will become ever harder to persuade them to cut pensions back. A struggle for resources will emerge between generations. Pensioners will press for higher taxes to fund the pensions and health care they believe they have been promised. Younger workers will demand cuts in increasingly onerous taxes.

Tensions are also likely between countries in the European Union. Britain and the Netherlands, which have high levels of private-pension provision and whose populations are predicted to remain more or less stable, are better placed to cope with the pensions problem. But they might still be affected by the financial problems of other EU countries, which could force up interest rates across Europe and undermine the euro. The fact that Europe's population is shrinking and ageing will inevitably also affect the aspirations of some Europeans to create a superpower to rival the United States. A recent report from the French Institute of International Relations predicts that, by the middle of the century, the EU's GDP will be growing at just over 1% a year compared with more than 2% in North America and at least 2.5% in China. The EU, the report gloomily concludes, faces a “slow but inexorable ‘exit from history' ”.

But while the EU has a rich, old and shrinking population, countries on the Mediterranean's other side have poor, young, growing ones. The tide of immigrants, legal and illegal, crossing the sea is an obvious

reaction. So shouldn't Europe be more liberal about immigration, to redress its population imbalance? An appealing idea. But the OECD calculates that immigration might have to be between five and ten times its current level just to neutralise the economic effects of ageing populations. Even today's inflow is causing political strains, with anti-immigration politicians like France's Jean-Marie Le Pen, Italy's Umberto Bossi and the Netherlands' late Pim Fortuyn popping up all over Europe.

A very European muddle-through

Persuading Europeans to have more children is the obvious alternative answer. Part of the problem may be what Italians call the “partial emancipation” of women, who are free to go out to work but are then still expected to bring up children, look after the grandparents and do the housework. Making family life easier or less expensive might help keep up the population. France, which has some of the most extensive state-funded child care in Europe, also has one of its highest birth rates. Sweden boosted its birth rate in the early 1990s by raising tax benefits for mothers. But the effect of that tailed off after a while. And as well as being costly and unpredictable, policies to encourage childbirth also make some Europeans uneasy, since they are associated with authoritarian government.

So Europe will probably try to muddle through its demographic problem. There will be some pension reform, a bit more immigration, more family-friendly policies, higher taxes, growing fiscal problems for many governments and slower economic growth. With luck the European Union will avoid or postpone a really huge economic crisis. But the political and economic renaissance of Europe that was predicted at the European convention is likely to be stillborn.

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Working time

Clocking off

Jul 17th 2003
From The Economist print edition

British workers are rebelling against long hours in the office

THE economy has slowed down but the labour market remains resilient. The latest figures show that unemployment has fallen and employment has risen. The ratio of employment to the working-age population is close to its all-time high. The government is both proud of this and worried that Britons work too hard. Pushing the “work-life balance” agenda, Patricia Hewitt, the trade and industry secretary, says that Britain's “long-hours culture” is “macho” and “old-fashioned”.

So how over-worked are Britons? Full-time employees certainly work longer than in other European countries. Their usual working week is the highest in the European Union: 43.3 hours compared with an average of 39.3 hours in the euro area and just 37.7 hours in France. Amongst full-time employees, a quarter of British men and a tenth of women usually work more than 48 hours a week.

But include part-time workers and the picture changes. Britain's part-time workers work fewer hours than most European countries, and part-timers account for 25% of employment in Britain, the second highest share in the EU. Looking at both part-time and full-time workers, the contrast with the EU becomes less marked. Taking into account holidays, average working hours are higher than in most European equivalents but lower than in Greece, Spain and Portugal.

“The main difference between Britain and the rest of Europe,” says Paul Gregg, an economist at Bristol University, “is that we have a far more diverse pattern of working times.” In European countries, he says, more people follow a standard working week. In Britain, hours range from the very short to the very long.

Many of those who spend longest in the office are professionals and managers. During the 1980s, they started working longer and longer hours. They embraced the American way of working, starting early and grabbing a quick sandwich at midday while hunched over the computer. A late start to the day followed by a long, boozy lunch became a folk-memory. Why? Probably partly because of higher unemployment, which meant more insecurity, and made people feel the need to show their dedication to the job, and partly because lower tax rates and rising pay at the top of the scale made working harder more worthwhile.

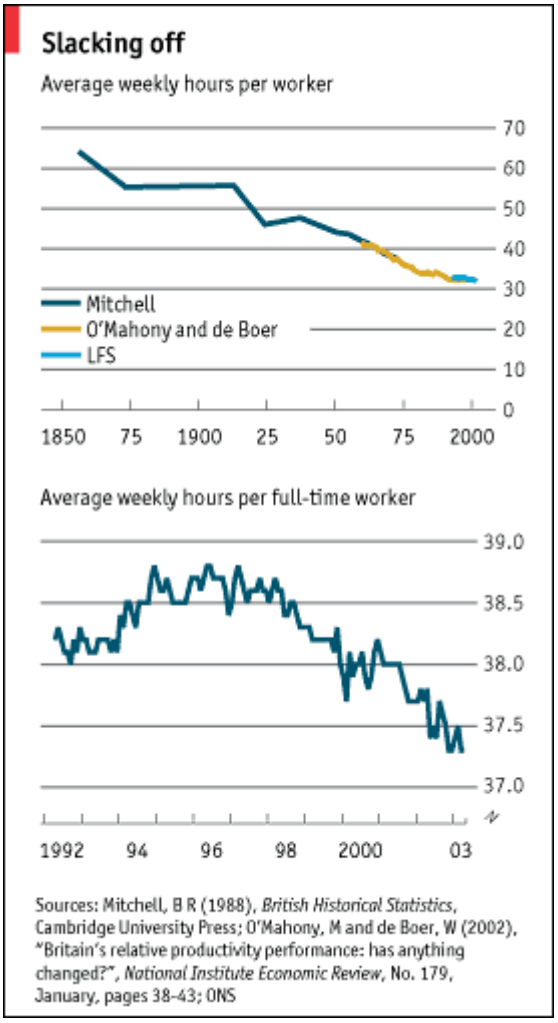
Yet, according to Mr Gregg, things are changing. “The long-hours culture does seem to be in decline.” In the past year, the average working week for full-timers has dropped by half an hour. Since 1998 it has dropped by an hour and a half for men and by over half an hour for women. By contrast, the working week of part-timers has risen by about half an hour over the same period.

The decline has been concentrated amongst men working very long hours. In 1997, 39% of men (including the self-employed) worked over 45 hours a week. But this has now fallen to 33%. By contrast the proportion of men working 31-45 hours a week has risen by four percentage points since 1997.

At first sight, the reason why long working hours have started to fall appears straightforward. In October 1998, the EU working-time directive came into force in Britain. This set a limit of an average of 48 hours a week for most workers and gave workers the right to four weeks' paid annual holiday. The introduction of the directive neatly coincides with the start of the reduction in working hours. If it is responsible for the reduction in working hours, the decline may not be over. In August, the directive will be extended to cover more than 700,000 workers in the transport industry. Next year it will be extended to trainee doctors (see article).

But Francis Green, professor of economics at Kent University, argues that the directive is neither the only

nor the most important reason. He points out that the self-employed are also working fewer hours, even though the directive does not affect them.



It may simply be that people are now doing what they always wanted to do. Mark Taylor and René Böheim, both economists at Essex University, have analysed the working-time preferences of workers throughout the 1990s. A third of them consistently said that they wished to work fewer hours even if this meant a commensurate loss of earnings.

Why do people now seem to feel they can do that? Probably because, as unemployment has fallen over the past decade, they feel more secure in their jobs. It may have something to do with family life, too. As the balance of power in households shifts, men may be listening harder to women's demands that they should occasionally show up in time for the bed-time story; and as more women join the workplace, men are needed at home more than they were.

The government, by going on about the "work-life balance" may have helped persuade people that staying at home isn't necessarily skiving. Attitudes among graduates are changing. "They are less willing to devote life and soul to their companies in their early years," says Nigel Meager, deputy director of the Institute for Employment Studies.

Looked at in the long term, there's nothing odd about this. Over the past 100 years (see chart) people have worked less and less as they have chosen to take some of the rewards of rising prosperity in the form of more leisure. It was the 1980s and early 1990s, as professionals first stepped up their work effort and then stuck at their desks in the hope of keeping their jobs, that were an aberration. Now workers are reverting to a familiar pattern, and sloping off from the office earlier and earlier. The government's campaign for the work-life balance looks redundant: life is winning.

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Doctors

Another headache

Jul 17th 2003
From The Economist print edition

The NHS can no longer exploit trainee doctors

JOHN REID, the new health secretary, set out the government's latest ambition for the National Health Service this week: the extension of choice among hospitals for patients requiring operations. By the end of 2005, all patients will be offered a selection of at least four hospitals.

But the promise of greater choice will prove an empty one if there are not enough doctors available to meet the demand for treatment. Britain has far fewer doctors per head of its population than does the rest of Europe, on average. One way that the NHS has been able to cope is by getting its junior doctors to work absurdly long hours. But this strategy is running out of time.

Under a new agreement, the maximum working week of trainee doctors will fall in August to 56 hours. However, they will still have to be on call—they can be asleep, so long as they are in a hospital—for up to 72 hours.

A more dramatic change will occur in a year's time when the EU working-time directive is finally extended to include junior doctors. The NHS has until 2009 to cut the maximum working week to 48 hours. But from August 2004, on-call time will be counted as working hours, so the reduction in medical cover will be substantial.

The Royal College of Physicians has sounded the alarm about the directive's impact on emergency services. A survey by the college has established that one in five hospitals will be hard-pressed to provide emergency services at night. These are typically hospitals with small casualty departments which lack the staff to man the new shifts needed to replace on-call rotas.

The NHS Confederation, which represents health-service employers, accepts that some hospitals will experience difficulties if nothing is done to prepare for the directive. “The answer has to be to run services in different ways,” says Nigel Edwards, the confederation's policy director.

The Royal College of Physicians advocates delaying the directive's implementation for three to six years. This would give Britain time to train more doctors and so help to overcome the problem. But the directive is unlikely to be postponed. It adds to the government's difficulties in delivering a better NHS.

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London's transport

Crossrail gets the go-ahead

Jul 17th 2003
From The Economist print edition

But who will pay to drive a new east-west rail route under London?

Get article background

SUPPOSEDLY, it will cost between £10 billion ($16 billion) and £15 billion. Bob Kiley, London's American transport boss, believes London businesses that would benefit from it would be ready to meet a large part of the cost. They'd better be, said the transport secretary, Alistair Darling, this week, as he gave the scheme the government's blessing; fork out, or it won't be built. But who actually needs Crossrail, a long-debated project for an east-west rail link under central London and far out (on routes yet to be fiercely argued over) in those directions? And just how is business to be persuaded, or forced, to pay up?

The scheme has been around formally since 1989 (when Margaret Thatcher's government put a mere £650m price tag on it) and in the air long before then. Backed by John Major's team, it got as far as a private bill in Parliament in 1994, but no further. Since then, it has survived: it is said to be a Good Thing, but few Londoners have asked why.

Parts of the case are bogus. Supposedly, it would “create 100,000 jobs”. Supposedly, it is essential for London's bid for the 2012 Olympics (“Can't be ready so soon,” said Mr Darling this week; “Nonsense,” said London's mayor, Ken Livingstone). The real case is the simple one: transport, year in, year out, for a city whose Tube lines bulge in rush-hour. They need not, argues Tony Travers of the London School of Economics if they were run like, say, Moscow's, which achieve 40-45 trains an hour at peak times, against the 30-odd, and often less, that London manages. But that won't happen. Instead, Mr Livingsone's Transport for London and the Strategic Rail Authority have teamed up to promote Crossrail.

The benefits would extend east and west: Essex girls could whisk straight to Heathrow; business-class flyers to the heart of London, instead of being dumped to wait for a taxi at Paddington; bishops from Reading could join the Channel Tunnel Rail Link at Stratford. The owners of Canary Wharf, the giant rival to the City of London, would love a spur going south-east beyond their turf to bring in ever more workers (and their bosses and demand for office space) from Kent.

Yes, but who pays? Companies will not just volunteer: when London Underground proposed an extension of its Jubilee Line to Canary Wharf, the developers pledged a fat subsidy, as well they might. It was never paid in full—but no one else offered anything at all. Economists call this the “free rider” problem: why pay if you'll get the benefit anyway?

So tax those who will gain? Mr Travers and a colleague once proposed an infrastructure fund for London, financed by a levy on all business rates. No way, say businesses far north and south of the proposed route. “Planning gain” is a familiar local-council tool, but it hits only new developments (“yes, you can build the estate, but you must build us a new community centre too”). A better answer might be to securitise and sell the extra tax revenues arising from higher property values; business property is due to be revalued in 2005. That would not catch out-of-London gains, but nothing's perfect. Consultation with business will begin in the autumn. Not that this is the only source of dosh that Mr Darling has to consult. He wants to tap someone else; name of Gordon Brown.

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About sponsorship

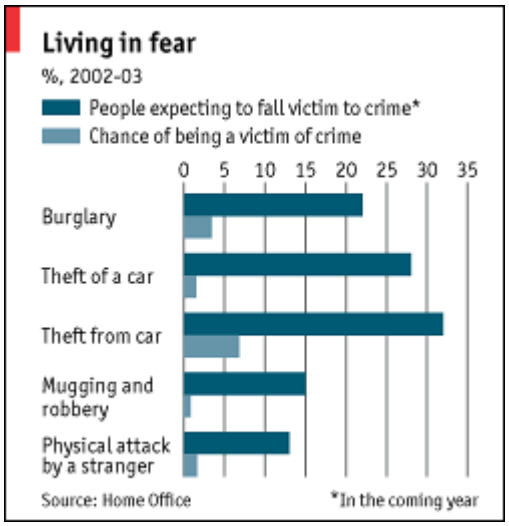
Crime

Fear itself

Jul 17th 2003
From The Economist print edition

The police are supposed to reduce fear of crime as well as crime. That's hard when there's little relationship between the two

THE release of the national crime statistics this week brought mixed news to those in the law-and-order business. Contrary to crimson-tinged reports in the national newspapers, the actual number of crimes committed has fallen by around 2%; an apparent increase is explained by new recording practices. But there was bad news, too. Thanks in part to the aforementioned newspaper reports, fear of crime is on the rise.



According to the British Crime Survey, 38% of people believe that crime has risen “a lot” in the past two years—up from 25% for those surveyed in 2001. A further third of the population reckons crime has gone up a little, while only 4% take the optimistic (and accurate) view that it has fallen. The number of people who worry about walking the streets at night and perceive their neighbourhoods to be disordered is also up.

For a government that concerns itself as much with perception as with reality, this is a problem; and the government has made it a problem for the police. Fear levels are now used as “best value performance indicators”, meaning that police forces have to keep track of them and think up ways of calming people down. In the coming year, watch for a lot of converts to the “reassurance agenda” and the doctrine of putting more bobbies on the beat.

There can be few better examples of the tail (in this case, an imaginary tail) wagging the dog. Fear of crime is a serious matter—when keenly felt, it can prevent people from living productive and fulfilling lives. It is, however, hard for police to do much about it. Ask people their feelings about crime, and you will dredge up a mess of concerns about things like social fragmentation, sexual permissiveness, immigration and racial mixing. As Elizabeth Stanko, professor of criminology at Royal Holloway College, London, says, “fear of crime is like a sponge: it absorbs all kinds of social anxieties.”

A further problem with targeting people's fears is that they bear only a tenuous relation to patterns of crime. Those least likely to suffer from crime often fear it most. So allocating police resources to people who are afraid may mean taking them away from people who are really likely to be victims.

This year's figures show that 16% of women over 60 think they are likely to be mugged—a fate that actually befalls fewer than one in two hundred. Meanwhile, young men, who are victimised at more than three times the national rate, are unusually unbothered. People living in Avon and Somerset seem irrationally calm, given above-average rates of burglary and car crime. But the inhabitants of Durham, who suffer around a quarter less crime than people elsewhere in the region, are very worried about it indeed; 26% have even managed to convince themselves that they live in a highly disorderly area.

What's more, gathering information about fear may generate more of the stuff. Some questions (“how worried are you that someone might break into your home?”) are unintentionally leading. Stephen Farrall, a Keele University criminologist who has surveyed Glaswegians, says that one man, who had reported very low levels of anxiety, rang a few weeks later to report that he had thought about nothing else in the intervening period. Mr Farrall has persuaded the Home Office to start surveys by asking people about how many times they actually experienced fear in the past year. Under this line of interrogation, levels of fear fall by around half—by more among the over-60s.

Given the intangible and messy nature of crime fears, it hardly seems reasonable to expect the police to assuage them. To try to do so may even turn out to be counterproductive. After all, much the easiest way to reduce fear of crime is not to cut crime itself, but to convince people that bad things are unlikely to happen to them. At first glance, that sounds reasonable; but it risks turning the police into public relations officers and lowering people's natural defences against crime.

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Jury trials

Carta starter

Jul 17th 2003
From The Economist print edition

The government wants more trials without juries. Peers don't

JURIES, the government thinks, let down the cause of justice. They may be nobbled, or confused by complicated fraud cases. But plans in the new Criminal Justice Bill to drop juries in such trials have been stymied by a crashing defeat in the House of Lords.

Two previous home secretaries, Michael Howard and Jack Straw, had already tried and failed to curb the right to jury trials. The current one, David Blunkett, had tried to face down the opposition by threatening to drop the entire bill, which includes popular measures such as tougher sentences for murderers and drug dealers, if the Lords voted down the clauses on juries. Now that bluff has been called, the government must decide whether to compromise, or to use its weapon of last resort, the Parliament Act, which allows it to force new laws onto the statute book even without the consent of the upper house.

The criminal justice system, as the government itself admits, is a mess. But the problems of jury trials are just a small part of the delay, bureaucracy and incompetence that all too often let wily crooks go free. Cases are postponed for flimsy reasons, wasting everyone's time. Cynical defence lawyers abuse all parts of the system. The under-resourced prosecution is often inadequate.

Some of the government's opponents want no change at all. Others want reform, but not by chipping away at the cornerstone of a centuries-old tradition of law and liberty. In the Magna Carta, which first curtailed the power of the state in 1215, King John promised that: “No free man shall be arrested or imprisoned or disseised [dispossessed] or outlawed or exiled or in any way victimised, neither will we attack him or send anyone to attack him, except by the lawful judgment of his peers or by the law of the land.” Good stuff—and a long way from the authoritarian tone of the Home Office under Mr Blunkett.

Even the defenders of juries admit they could work a lot better—by, for instance, encouraging working people to take part in them, rather than offering every possible loophole to avoid jury service. Better security would help prevent nobbling by criminals, and tougher penalties deter it. But tamper with the fundamental principle, as Mr Blunkett has found, and you risk being nobbled by peers.

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Judges

White wigs

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The government wants a more diverse judiciary. Why?

JUSTICE, says the old saw, must not only be done; it must be seen to be done. To Lord Falconer, the new lord chancellor, who is in charge of a hurried reform of the judiciary, this means it should be dished out by judges who are a bit less white, a bit less Oxbridge-educated and a bit less male.

No blacks or Asians, and only ten women, hold a rank higher than circuit court judge. And senior judges' social background is in some ways narrower than it used to be. In 1940, eight out of thirty-five top judges had not attended university. In the 19th century there were more aristocrats and more judges of working-class origin than today.

Judges are also, per the cliché, out of touch with modern life. Splendid proof of this emerged last month, when a high court judge presiding over a dispute between two garage music groups felt obliged to declare his ignorance of a “foreign language”. Yet it is not clear that ordinary people mind this sort of thing very much. And, unlike the police, the judiciary does not depend on public goodwill in order to function.

Moreover, most people who end up in court never see a judge, let alone a senior one. Some 95% of criminal cases are heard by lay magistrates, who are an admirably representative lot—49% are female and 6.1% non-white.

There's something to be said for having more women and ethnic minorities on the top benches, if only to prevent home secretaries from accusing them of being out of touch. But the Bar Council suspects the government's motives. It believes the diversity issue is a Trojan horse for an assault on judicial independence. If this is so, it would not be surprising: senior judges are increasingly at loggerheads with the government. A fight looms over the make-up of the new judicial appointments commission, and over the possible use of veto power by the constitutional affairs minister. It is likely to be messy.

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Offshore energy

I'll huff and I'll puff

Jul 17th 2003
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The government plans a surge in offshore wind power. It'll be costly

WIND power this week got its biggest official puff since Queen Elizabeth I's medal-makers thanked it for scattering the Spanish Armada. The trade secretary, Patricia Hewitt, invited bids to build new offshore wind farms that could (she hopes) be supplying some 5% of the nation's electric power by 2010. At a cost.

Renewable, nuclear-free and non-polluting, wind power is a greenie's dream. Better still when it is out at sea, too far off to offend those who dislike its elegant but unnatural towers. But it is not cheap. Capital costs—much the biggest element, since the fuel is free—are falling as the technology and the industrial scale develop, to about £1m ($1.6m) per megawatt of offshore capacity, two-thirds of that onshore. But power from a new onshore wind-farm still costs about 3p per kilowatt hour to produce, far less than nuclear power, but well above the 2p of a new gas-fired plant.

Denmark, Europe's leader offshore, used large subsidies to build up its wind power, and still gives some, though these are now being cut. It also forced electricity suppliers to use some wind power. Britain does the same. Suppliers must get a rising share of their power—4.3% today, 10.4% by 2010—from renewable sources, or buy certificates of virtue from “renewable” suppliers, or pay Ofgem, the regulator, 3p per kwh, which it passes on to the virtuous.

Onshore, the result is 580MW of wind-power capacity, enough to meet 0.45% of demand. Offshore capacity is still tiny: two 2MW turbines off Blyth, in Northumberland. But there should be 1,500MW by 2006—if all the 17 projects, in 13 areas, licensed in 2001 get built on time. So far only one of these wind farms is really under construction, off Prestatyn, in North Wales, being built by a subsidiary of Innogy; it should produce its first power this year. Powergen's scheme off the Norfolk coast near Great Yarmouth will be next.

Although a huge step for the industry, that first round of licensing was, in a wider context, tiny: since winds vary, wind farms produce only about a third of their capacity, and 1,500MW will meet only 1.3% or so of today's overall demand. The new licensing round aims at a further 6,000MW installed by 2010 in three areas—(well) out from the Thames estuary and the Wash, and off the coasts of Lancashire and Cumbria. This extra 5% or so from wind power will not end the need for new plants of other sorts: short of a slump, demand will rise more than that in seven years. But it will be serious business.

Not too serious, though; which is the best answer to critics who fear power cuts if Britain's winds all stop at once. First, they won't. Second, offshore winds, though variable, are fairly predictable. Third, the industry can handle variations within 5% of supply or even the 10% (from all renewable sources) that is the government's target for 2010. Denmark gets 18% of its power from wind, and Copenhagen doesn't go dark on still evenings.

Britain will also gain a new industry; the world's leading wind-turbine maker, a Danish firm, Vestas, has already set up in Scotland. Yet will the new offshore wind farms make money? And if doubts about that persist, will they even get built? Wise capitalists do not rush to finance long-term projects that depend on public subsidy. Hence, in part, the time it is taking to turn first-round licences into turbines. It is a fair bet that offshore power's capital cost will fall. But what will the returns be? In principle, the rules

requiring distributors to get *x*% of their power from renewable sources are to last till 2027. But principle is apt to lose to politics, and no figures for *x* have been fixed beyond 2010. The industry dearly wishes that they would be.

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Education

Get bac

Jul 17th 2003
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Teenagers may have to go on studying subjects they hate

Get article background

AS PARENTS know all too well, forcing teenagers to do things, even for their own good, is an exhausting and sometimes futile business. So the draft proposals launched on July 15th for a new system of exams, including some compulsory subjects, risk provoking slammed bedroom doors all over the country.

Under the current system there is no compulsion after 16, the age when most students do their GCSE exams. Even with a poor grade, or none, they can go on to further study at A-level. Thus maths-hating Sophie can drop everything apart from (say) art, music and French. Her brother Sam, who loves sums and loathes books, can do maths, physics and IT, undistracted by anything more unquantifiable.

When it ran properly, that system enabled Sophie and Sam to go on to short, concentrated university courses. But its flaws have been increasingly visible. Too many pupils became fed up and dropped out at 16. Standards have drifted down, both in those taking the courses and those examining them. Last year parents complained furiously about botched marking. That prompted the government to set up a working party under Mike Tomlinson, a former chief schools inspector, which issued its preliminary report this week.

The proposed system, of three types of diplomas, aims for breadth and depth. At the top end it would mean more demanding courses for bright students who are not properly stretched in the current system. At the other end, it would also give some sort of qualification to the many less able children who currently leave school with few or no exam results to show for it. It would rank vocational qualifications in hands-on subjects along with academic ones: plumbing would count towards a diploma just as much as media studies.

By past standards, the proposed system would be more prescriptive, adding to pupils' chosen subjects a bunch of mandatory “core” skills—including literacy, numeracy and computer competence, as well as extra-curricular activities like art, sport and community work. The diploma would depend on passing the core subjects—even in yukky maths and softie English. For all the breadth, the new exam would be nothing like as tough as the highly regarded International Baccalaureate, which is taught at around 50 mainly private schools in Britain. Independently designed and assessed, that suffers from none of the political interference and pressure for higher marks and less work that have wrecked the existing system.

The draft proposals are now up for discussion. The reaction has been cautiously favourable. Nobody thinks the current system works.

In one big respect the new proposals look very sensible. If Sophie can understand the basic mathematics behind risk, for example, then she will make better choices on everything from immunisation to diet. Maths and the other core skills will not necessarily be studied all the way to 18, but at some point in their school career, children should pass some solid milestones in these important subjects. Some could manage that quite early; others may have to plug away until they leave school. The sooner the compulsory stuff is out of the way, the more time both Sam and Sophie will have to devote themselves to the subjects they like.

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Bagehot

A poodle that snaps

Jul 17th 2003
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Tony Blair needs a good row in Washington

AT THE end of a three-day love-in for the international centre-left, otherwise known as the Progressive Governance Conference, its host, Tony Blair, looked happier and more confident than he has for months. The Third Way, everyone agreed, was still the only way to deliver the kind of government people wanted. It was just the kind of boost Mr Blair needed before setting off on his holidays. Unfortunately for Mr Blair, there was a ghost at the feast, apparently unnoticed by him, but evident to almost everyone else.

The ghost in question was due to receive Mr Blair in Washington, DC, as *The Economist* was going to press. Although the delegates from more than 30 countries and the 12 centre-left heads of government who had gathered in London for the conference were much too polite to say so, Mr Blair's close relationship with President George Bush is to them a genuinely shocking thing. Even Bill Clinton who, on leaving office, had urged Mr Blair to establish a close working partnership with Mr Bush and had personally supported the war in Iraq, had to draw a veil over it. When Mr Clinton made an interesting speech about how the Third Wayers could see off their foes on the left and right, the old campaigner was prevented from mentioning Mr Bush's growing political vulnerability over the war, because to have done so would have caused acute embarrassment to his dear and loyal friend, Tony.

Mr Blair doesn't need to be told about the price he has paid for going to war with Mr Bush. His reluctance to be presented with the congressional medal of honour during this trip to Washington tells its own story.

The steady erosion of the government's case for war in recent weeks has changed the prevailing view within the Labour Party. Only a minority questions his sincerity. But it's fair to say that even moderates now think that once Mr Blair realised Mr Bush was intent on toppling Saddam Hussein, the issue was not whether Britain should join in, but how its participation could be justified. Mr Blair, it is now widely believed, prosecuted an unnecessary war largely, if not entirely, because of an overwhelming desire to prove to Mr Bush his steadfastness as an ally.

However unfair this may be—and there's much to suggest that Mr Blair, if not Mr Bush, continued to hope that coercive diplomacy would make war unnecessary until relatively late in the day—Mr Blair knows he has been damaged. Unless he can undo some of the damage, his chances of ever implementing any of those enlightened, rational, modernising, evidence-based Third Way policies that so enthused him at the Progressive Governance Conference are remote.

Is there anything, apart from suddenly unearthing stocks of WMD or garrulous Iraqi scientists, that might help to get the prime minister off this terrible hook? Just as the perception of Mr Blair's eagerness to please Mr Bush has got Mr Blair into this mess, it is just possible that by turning that perception round, the prime minister could do himself some good.

No more Mr Nice Guy

In other words, the one thing that might help Mr Blair is to make a greater and much more public display of assertiveness with Mr Bush. For all that Mr Bush appears to have honoured every private undertaking he has given to Mr Blair—from engaging with the ultimately doomed United Nations process, to making a far more concerted commitment to the Middle East “road map” than sceptics expected and even taking some interest in Africa—the prime minister has not received the credit he deserved for these achievements precisely because it all happened in private.

Keeping things private also means that Mr Blair does not get credit for disagreeing with Mr Bush either,

as the British prisoners being held at Guantanamo Bay illustrate. Ever since their detention, there has been unease about their treatment and eventual fate (although it is not the case, as some presume, that the Americans have ignored British demands for their repatriation: the British government has no wish to have them back).

Instead, the Foreign Office has tried to persuade the Americans, with much behind-the-scenes petitioning, that the proposed military tribunals are both a propaganda disaster and a denial of justice—for all the prisoners, not just British ones. But this has done little to impress MPs, who say the men may be terrorists, but they're our terrorists and should be prosecuted in a British court. Belatedly, Mr Blair seems to acknowledge that he should be seen to make a principled stand over the treatment of these men, but he sounds too much like a timid supplicant.

The aftermath of the war has left plenty for the coalition partners to disagree about. But if they fear falling out on such sensitive ground, there is no shortage of decent arguments for Mr Blair to have with Mr Bush about other, back-burner, issues, from unjustifiable steel tariffs to America's infuriating refusal to sign up to the International Criminal Court.

The usual British position about the way to handle disagreements with the Americans, exaggerated by Mr Blair's instinct for getting on with people, is that real influence depends on saying what has to be said behind closed doors. This contrasts with French-style grandstanding that is high on domestic feelgood, but low on achievement. The Blair way is admirably grown up and effective at times, but does encourage poodle jokes.

Mr Blair may like and respect Mr Bush, but affection never prevented Margaret Thatcher showing her feelings when she thought that Ronald Reagan was acting against British interests. Over the Falklands, the invasion of Grenada and Mr Reagan's willingness at Reykjavik in 1986 to bargain away Britain's nuclear missiles, Mrs Thatcher was happy to roll her sleeves up. A few well-chosen rows with Mr Bush need not harm the relationship, and would do Mr Blair some good back home.

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Priceless

Jul 17th 2003
From The Economist print edition

Panos

More money is needed to solve the world's water problems. But even more important, argues John Peet, is the application of economic principles, particularly pricing and markets

Get article background

THE ancient mariner had it right. In Coleridge's poem, the glittering-eyed, becalmed sailor famously bemoaned the paradox of “water, water everywhere, nor any drop to drink”. Water is by far the commonest substance on earth, but 97% of the total is seawater, unfit for human use. Of the 3% that is fresh, two-thirds is locked up in glaciers or ice and snow around the poles. Only 1% of all the world's water is available for human consumption.

Water is literally vital: without it, life could not exist. But even 1% of the earth's available water should be enough for all. In a natural water cycle, rainwater falls from the clouds on to the land, nourishes life, returns through rivers to the salty sea and evaporates as fresh water back into the clouds. Except for a few sources, such as fossilised groundwater, it is not at all like oil or coal: water is infinitely renewable.

Yet two big obstacles stand in the way of delivery of water to people. The first is that it is often in the wrong location. Some places, such as Canada, Austria and Ireland, have more water than they can possibly use; others, such as Australia, northern China and the Middle East, have too little. In many parts of the world, such as India and Bangladesh, rainfall is highly seasonal: almost all the year's supply may arrive within a few months. There are variations even at local levels, as a “water poverty index” shows for two villages 20 miles apart in Tanzania, (see article). Water is also heavy, which makes it costly to transport over long distances.

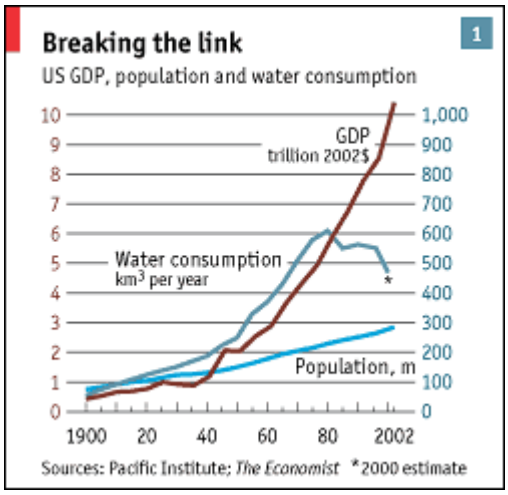
The second, bigger difficulty with water is, however, neither physical nor geographical: man's extravagantly wasteful misuse of it. This stems largely from a wilful refusal to treat water as an economic good, subject to the laws of supply and demand. Water, the stuff of life, ought to be the most precious of all gifts. Yet throughout history, and especially over the past century, it has been ill-governed and, above all, colossally underpriced. Indeed it is often given away completely free. Not only does this ignore the huge costs of collecting, cleaning, storing and distributing it, to say nothing of treating waste-water and sewage. It also leads to overuse of water for the wrong things, especially for highly water-intensive crops. This survey will argue that the best way to deal with water is to price it more sensibly—to reflect, so far as possible, the costs of providing it (including environmental costs), as well as its marginal utility.

In the past few years water has become the stuff of international politics. Last March's world water forum

in Kyoto, Japan, was only one of a plethora of conferences devoted to it. The United Nations has declared 2003 to be the international year of fresh water, and produced two heavy tomes in support. The Johannesburg earth summit in August 2002 agreed to reduce the number of people without safe access to clean water and basic sanitation by half by 2015. Today, over a billion people in developing countries have inadequate access to water, and 2.4 billion lack basic sanitation. Last month's G8 summit in Evian (a French spa town), appropriately, had water on its agenda, though in the event it did little more than reaffirm the Johannesburg goals.

Pricing ought to be a big part of such discussions, yet many green lobbyists hate talking about it. They believe that it is immoral to charge for water because the stuff is essential and God-given; that private-sector involvement in water is an ethical disgrace; and that interference with the flow of rivers, such as dam-building, is environmentally disastrous. They claim that water consumption inexorably grows with income and population, and that this will lead to increasing shortages and even to wars. The world is fast running out of water, they say, and extravagant domestic consumption is to blame.

To take this last claim first, the world is not running out of water, partly because the natural cycle perpetually renews it but also because the growth in water consumption no longer seems to be correlated with growth in GDP and population (see chart 1 for what is happening in the United States, the world's most profligate user of water). According to Peter Gleick of the Pacific Institute in Oakland, California, in the 1930s it took 200 tonnes of water to make a tonne of steel in America; now it takes only 20 tonnes of water, and the best Korean methods use only 3-4 tonnes. Toilets, which account for the biggest domestic use of water, show a similar gain: from six gallons of water per flush in 1980 to only 1.6 gallons in the latest models.



Domestic consumers are hardly ever to blame for water shortages. As much as 50% of the water in piped systems is lost through leakage. More important, wherever in the world water is scarcest, which is mostly in developing countries, irrigation for agriculture gobbles up at least 75% and sometimes as much as 90% of the available water. In richer countries, industry and energy use a surprisingly large amount. Domestic users everywhere account for a relatively small share (see chart 3). Any shortages should thus be blamed on farmers and manufacturers, not on swimming-pool owners.

As for the idea that future wars will be about water not oil, it is true that water has played a critical role in the Arab-Israeli conflict, and it has sometimes been a proximate cause of fighting elsewhere. But the management of water, especially of rivers, cries out for co-operation, and it has more often been linked to peace than to war. The Indus river partnership functioned through successive clashes between India and Pakistan; the Mekong has been a co-operative venture even though the region through which it flows has been racked by war; and the ten squabbling countries of the Nile basin have signed up to a compact brokered by the World Bank.

The critics' hostility to profit and the private sector is equally misconceived. Water delivery and treatment are highly capital-intensive businesses. As Gérard Mestrallet of Suez, the world's biggest water company, likes to say, “God provided the water, but not the pipes.” Wherever that capital investment comes from, somebody has to pay for it: if not users, then taxpayers or aid donors. For the people who now have no access to clean water, what matters is whether water comes out of the tap, not who delivers it.

Dams, too, are the subject of a noisy debate. Certainly many have been built with little regard for cost or for the environment. But to revert to the purely natural state that some greens advocate is to ignore the dams and water diversions that have been an integral part of civilisation ever since it began along the lower Tigris and Euphrates (in today's Iraq). The Romans built aqueducts everywhere.

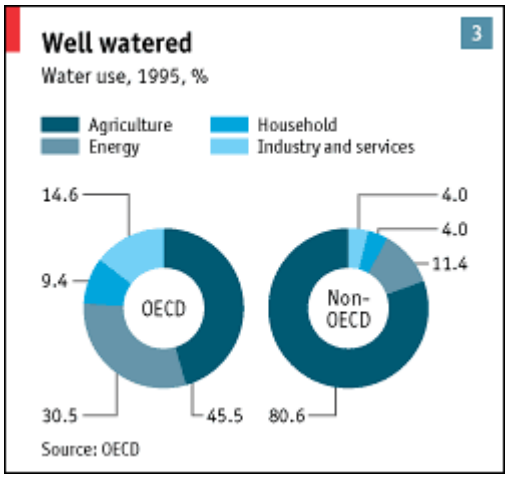
A soluble problem

The Johannesburg goals of reducing by half the numbers without access to clean water and basic sanitation are pressing; as Michel Camdessus, a former managing director of the IMF, says, no other development goals can be met without them. At present, millions of poor people (usually women) must walk for several hours a day to get water; or they pay through the nose to private water vendors. Either

way, the water's quality is often poor. Inadequate sanitation makes matters worse. As much as 60% of the world's illness is water-related. The surprising thing, indeed, is that more has not been done to improve water access and sanitation before.

Meeting the goals will certainly take a huge investment (so it is unfortunate that Britain's development ministry has cut the share of its aid going to water from 5% in 1997 to 3.5% last year). Yet there is room for argument about how much is needed. In 2000, a group under the auspices of the World Water Council (WWC) and the Global Water Partnership (GWP), two big international quangos, reckoned that investment in water in poor countries was running at about $75 billion-80 billion a year, and suggested that this would have to be raised to some $180 billion. That figure was the starting point for a panel on the financing of water commissioned by the WWC and chaired by Mr Camdessus, which reported in March this year. The Camdessus report was criticised by many lobbyists for promoting privatisation and big dams, and even dismissed as a bankers' panel—though as Jim Winpenny, its secretary, tartly observes, it was meant to be that, because its subject was financing.

Other experts put the cost of achieving the Johannesburg targets somewhat lower. Margaret Catley-Carlson, the GWP's president, talks broadly of a doubling of investment. But WaterAid, a respected British-based charity, suggests that an extra $35 billion a year would be enough. Its planning director, Stephen Turner, says that appropriate provision often means standpipes in villages, not piped water to every home; and when resources are scarce, there is little point in treating all water to drinking quality, since much of it is used for cleaning or washing. Sir Richard Jolly, chairman of another quango, the Water Supply and Sanitation Collaborative Council, praises the effectiveness of “VIP latrines” (the acronym stands for ventilated improved pit), compared with far costlier sewage systems. He also notes that simply washing hands with soap is the best single sanitation measure.



Beyond money, the Johannesburg goals require action. To meet the one on sanitation, for instance, will mean bringing service to 400,000 new people every day: a daunting task, especially in countries lacking good government. And, as the GWP's mantra puts it, “Water is a problem of governance, above all.”

Yet despite the difficulties, the Johannesburg targets—and also Mr Camdessus's own professed aim of achieving universal access to clean water and basic sanitation by 2025—are achievable. Delivering clean water and removing waste-water is expensive, but it is not rocket science. Plenty of public and private bodies know how to do it. This is one of the few environmental problems that is, as it were, soluble. And the best way of solving it is to treat water pretty much as a business like any other.

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Measure for measure

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From The Economist print edition

How to interpret all those water league tables

THERE is no shortage of figures on water; the problem is how to interpret them. Water consumption rates, for example, vary hugely. America comes near the top, using almost 1,700 cubic metres per person per year. That is almost twice as much as Australia and eight times as much as Britain. Many poor countries use far less. Yet it would be wrong to treat such figures as signs of profligacy. Much depends on climate, how much water a country has, whether farmland needs irrigation and so on. Australia uses lots of water in gardens; 85% of India's water goes on irrigation; Canada has more water than it knows what to do with. What nobody disagrees on is that the Americans are the most wasteful of all.

All right for some 2

	Water withdrawals m^3 per person*	Water poverty index ranking†
United States	1,688	32
Canada	1,431	2
Australia	945	44
Japan	723	34
Germany	712	35
India	497	100
Finland	469	1
China	431	106
South Africa	288	103
Britain	201	11

Sources: The World's Water 2002-2003; Centre for Ecology and Hydrology; World Water Council

*2000 estimate †2002

Water-quality indicators are equally hard to assess. There was much sniggering earlier this year when the United Nations published a league table of water quality showing Belgium at the very bottom, behind such places as Sudan and India. At the top were Finland, Canada, New Zealand and Britain. But such judgments are speculative, and though pollution is a factor, a bigger one is simply how much fresh water is available.

The most ambitious measure is the “water poverty index” developed by a team led by Caroline Sullivan and Jeremy Meigh at the Centre for Ecology and Hydrology in Wallingford, England. The index combines five measures: available resources, access to water, people's capacity to afford and organise water supplies, use of water for domestic, industrial and environmental purposes, and environmental management. It is intended to provide guidance to policymakers on where to concentrate their efforts.

Ms Sullivan and Mr Meigh stress that their indicator works best at community level, where it can be based on first-hand assessments that capture variations between neighbouring villages. Their pilot study did this in South Africa, Sri Lanka and Tanzania. But they also use published statistics to compile water-poverty indices for whole countries. Once again, Finland and Canada come out best, followed this time by Iceland and Norway. The worst performers are a clutch of poor countries, with Haiti bringing up the rear.

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Private passions

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The private sector has an important role to play in providing water services

IF WATER is best treated as a normal business, that runs slap into the most controversial issue of all, which exercises the activists more than any other: the idea that the private sector can and should provide water and sanitation services. Some critics are against all forms of privatisation; others work for public-sector unions, so they have an axe to grind. Many think that, because water falls from the sky, it should be free. Others argue that, as “water is for life”, it is wrong to sell or trade the stuff for a profit. It is notable that those who most fervently hold such beliefs often come from countries such as Canada, rich in both money and water.

The opposing side holds equally strong views, arguing that many public utilities have shown themselves incapable of delivering water and sanitation satisfactorily, so private companies should be given the opportunity to do better. In the 1990s, the World Bank seemed to espouse this view. Much of the Camdessus report is devoted to suggestions for helping the private sector win contracts in developing countries. Yet that may be ignoring a simple arithmetical fact: at present over 90% of the world's water is delivered by publicly owned bodies, so there is no doubt that the Johannesburg goals will have to be met substantially by the public sector.

Private suppliers have in fact long played a role in water. Most of today's municipal and state-owned water utilities in America and other rich countries began life as private companies. Strikingly, in France most municipalities have for almost 150 years been supplied by one of the two giants that still dominate the world water industry: Générale des Eaux, now owned by Veolia (formerly Vivendi Environnement), and Lyonnaise des Eaux, now owned by Suez (see article).

The best test of the private v public argument is, however, to be found across the English Channel. Until 1989, most British water was delivered by public utilities, organised around river basins rather than municipalities. As in America, there were some small private companies, but these were little more than historical curiosities. Yet in 1989 the privatisation programme introduced by the then prime minister, Margaret Thatcher, reached water, and all ten English and Welsh water utilities were floated on the stockmarket. Instead of retaining the assets in public hands and franchising out operations and maintenance, as France had done, the British government chose to privatise the assets as well.

English lessons

How does the record look 14 years on? In terms of quality, service delivery and efficiency, the answer is excellent; in terms of stockmarket performance, less so. At the time of privatisation, thanks to years of Treasury cheese-paring, the British water utilities faced a daunting backlog of capital investment needed to comply with European water-quality directives. This persuaded the government to hand the new water companies a lavish dowry. They were forgiven all their debt and allowed to hike up prices. Sir Ian Byatt, the first director of Ofwat, the new water regulator, now concedes that the initial regime was too generous; shareholders who bought at flotation made a killing, prompting the Labour opposition to hatch plans for a windfall tax when they returned to power.

Ofwat's price regime was tightened at reviews in 1994 and 1999. By then most of the much-needed capital investment had been made, and efficiency gains had kicked in. Yet several utilities, especially those that had taken on the biggest debts, were feeling the pinch. A painful windfall tax was duly imposed in 1997, and shareholders began to grumble. Mergers between utilities were frowned on by the regulator, so that avenue to cost-cutting was closed, and the utilities had to look for other solutions. Some merged with regional electricity companies, others were sold to the French or other foreign companies. Welsh and Yorkshire (now Kelda) Water pondered becoming mutually owned companies. The regulator blocked Kelda's plan, but allowed the sale of Welsh Water to Glas Cymru, a sort of mutual

owned by a group of local investors. Table 4 summarises the utilities' present status.

Private ups and downs 4

British privatised water companies

Company	Subsequent changes
Anglian	Put up for sale by AWG, 2003; planned purchase by WestLB abandoned
Welsh Water	Hyder formed in 1996 from Welsh Water and Swalec. Welsh Water sold to Glas Cymru, a not-for-profit company, in 2001
Northumbrian	Bought by Suez in 1996. Sold to institutional investors led by Deutsche Bank in 2003, with Suez keeping a minority stake
Severn Trent	No change
South West	Bids by both Wessex and Severn Trent blocked by government in 1997
Southern	Bought by Scottish Power in 1996. Sale to Vivendi blocked by DTI in 2002, bought instead by Royal Bank of Scotland in 2003, with minority Vivendi stake
Thames	Bought by RWE in 2000
North West Water	Merged with Norweb to form United Utilities in 1995
Wessex	Bought by Enron in 1998. Sold to YTL in 2002
Yorkshire	Tried to become a mutual; idea rejected by regulator in 2001. Now renamed Kelda

Sources: Water UK; *The Economist*

Does such a topsy-turvy experience deserve a favourable verdict? The answer is to be found north of the border, in Scotland. In 1989, Scotland's water was comparable to the English utilities in every respect, but the government kept it in public hands. For a while, the Scots benefited from lower bills. But as the new Scottish regulator, Alan Sutherland, recently conceded, things look different now. Scottish Water is less efficient than its southern peers, its service delivery is poorer and its water quality is worse; it is, in short, ten years behind. To catch up, it is having to raise water tariffs above English levels. The Scots, it turns out, are paying a high price for keeping their water in public hands.

Yet not everything about British privatisation has gone swimmingly. Household metering, a precondition for sensible pricing, remains limited, with only a 50% coverage at best (Anglia). This is partly because in 1997 the new Labour government made metering voluntary: a policy that was bound to fail, because the only people likely to volunteer to have a meter installed are those who think they consume less than average and will receive lower bills. On the delivery side, Yorkshire Water suffered embarrassing water cut-offs during a drought in 1995-96. And because of the regulator's opposition to mergers, no strong national champion has emerged to challenge the French. Only Thames has a substantial presence abroad, and it is now owned by Germany's RWE.

One lesson the British utilities have learnt is that privatisation cannot mean they are free to conduct their business as they wish. Because water supply is a natural local monopoly, any privatisation requires a strong and permanent public regulator. In a sense, privatisation is a misnomer. The water remains under government control; tariffs and services remain tightly regulated; and even if assets such as sewers and pumping stations are transferred to a private company, their use is circumscribed, and the companies are licensed to operate only for 25 years. Formally speaking, London's famous Victorian sewers are “owned” by a German company—but not in the sense in which the makers of Rolls-Royce cars are owned by a German company.

Few other countries are willing to go down the British route, even if they acknowledge its successes. More are attracted by the French model: keep the assets in public hands, but contract out investment, operations and maintenance. Among rich countries, America has toyed with this, and a number of cities have offered concessions to both American and foreign companies, though the results have not always been happy. For example, Atlanta first let and then cancelled a contract with Suez. In Europe, Germany is sticking to public ownership (except for Berlin). In Spain, however, half the water is supplied by private firms, the biggest being Aguas de Barcelona, controlled by Suez. But the real opportunities for the private sector lie in poorer countries, where public provision has so often been inadequate.

The four biggest private companies are Suez, which claims 125m customers, Veolia, with 110m, Thames (now RWE), with 70m, and Saur, part of France's Bouygues construction group, which has 25m. In the 1990s, all of them duly piled into the developing world, but none of them has had a happy time there. Peter Woicke, head of the World Bank's private-sector arm, the International Finance Corporation (IFC), notes that if any water company were to announce that it was quitting emerging markets, its share price would go up. The companies have learnt that the risks of setting up in a developing country are greater than they thought—and the rewards lower than they hoped.

In Manila, for instance, the World Bank had thrice lent money to the municipal utility, only to find that universal coverage remained a distant goal, much of the cash was siphoned off and half the water was still disappearing through leaks or theft. So in 1997 it encouraged the Philippine government to let a concession to a Suez subsidiary. Last December, the subsidiary pulled out, citing big debts, disputes with the municipality over its failure to invest and an argument over price increases. For similar reasons, Suez is also thinking of quitting Jakarta, though its co-concessionaire, Thames Water, is hoping to stay.

The real test bed, however, has been Latin America. There, too, the World Bank encouraged cash-strapped governments to let water concessions to the big private companies, especially Suez and Vivendi. For a time the model was Buenos Aires, where the concession was awarded to a subsidiary owned mainly by Suez, Aguas Argentinas (the IFC also had a stake). The contractor managed to cut water tariffs and to extend 24-hour service to an extra 3m poor people, who found that their piped supplies cost one-tenth or less of what they had been paying to private water vendors. Unfortunately, the catastrophic Argentine devaluation of early 2002 destroyed the economics of the operation; the government refused to let Aguas Argentinas invoke a clause allowing it to raise prices to offset the devaluation, and Suez pulled out. The dispute is now in the arbitration courts.

In Bolivia, three big cities, La Paz, Santa Cruz and Cochabamba, all devised schemes to improve chronically deficient water supplies (in a country with above-average rainfall). La Paz awarded a contract to a Suez subsidiary; this has extended supply to the poorer El Alto region of the city. Santa Cruz chose to improve the municipal water utility instead, using World Bank loans, as La Paz had done (and so disproving the myth that the Bank lends only to privatised schemes).

Cochabamba had bigger ambitions. The local mayor wanted to build a large dam and tunnel to tap another watershed. Again the World Bank was asked to help, but refused on the ground that the scheme was too costly and unnecessary. The Bolivian government went ahead anyway and gave a contract to a consortium in which Bechtel, an American construction firm, was the lead partner. But when the consortium doubled water tariffs to pay for the investment, and some people found themselves spending one-third of their income on water, protests erupted, culminating in mass demonstrations in the main square in early 2000 during which a 17-year-old boy was shot dead by a soldier. The government panicked, the project was scrapped and the water contract was torn up. The Bechtel-led consortium is now suing for $25m in damages.

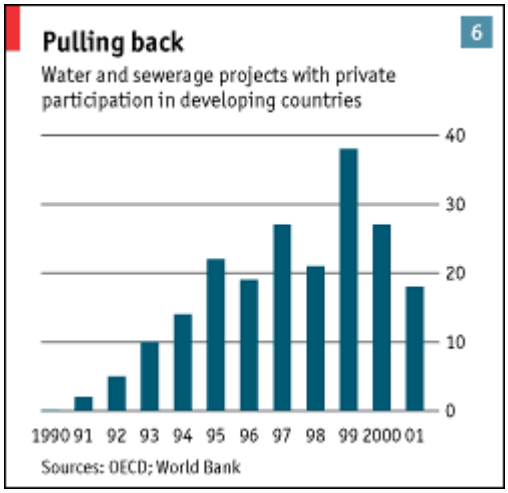
Don't do as the Cochabambans did

What are the lessons from Cochabamba? It has become the poster child for the anti-privatisation brigade. In this, most NGOs, as well as the media, have taken their lead from Oscar Olivera, a quietly spoken but forceful shoemaker and union leader who found himself leading the protests. Mr Olivera is firmly against any privatisation of water. He proudly declares that, now that the consortium has been seen off, water tariffs are back where they were before it arrived; and that Semapa, the local utility, has been restructured and improved with the help of a some cash lent by the Inter-American Development Bank. Yet the fact is that 40% of Cochabambans today still lack access to water—just as many as did before the private contract was let.

The correct conclusion from the Cochabamba fiasco has little to do with privatisation. The mayor and the Bolivian government were wrong to insist on an expensive and unnecessary dam. But the bigger problem was that Semapa's water tariffs had been too low for too long, starving the system of investment. Had the tariffs been raised earlier, more cash would have been available to improve service. These twin failings meant that any new contract, public or private, was bound to lead to unacceptable price rises.

One observer of privatisation projects, Michael Rouse of the International Water Association, sums up the issue: “There have been successes with public/private partnerships, and there have been failures. The key requirement is good governance and the right institutional framework, notably effective regulation.” Unless this requirement is met more often, private companies may continue to be unenthusiastic about projects in developing countries (see chart 6). One way forward could be more creativeness in the use made of the private sector. The companies have much to offer in services, operations, maintenance and billing. But they cannot be substitutes for good local government; nor, as Suez's Mr Mestrallet laments after the Argentine mess, are

they bankers.



Jeremy Pelczer of Thames Water talks of developing new kinds of partnerships between the public and the private sector, with companies such as Thames taking only a 20-25% equity stake in special-purpose vehicles. Thames also works on joint projects with NGOs such as WaterAid. Mr Pelczer says his ambition is to be “the easyJet of the water business”, supplying know-how and management skills, but in conjunction with other bodies. This also offers a way to harness private-sector expertise for water and sanitation in rural and small-town areas: on their own, the big companies will never be interested in anything much smaller than a city of 500,000 people.

The Camdessus report contains some good ideas for financing public/private partnerships in water. One of them, modelled on American experience, is to raise money from local investors in poor countries through bond issues. A second, aimed at the Argentina problem, is to set up a devaluation backstop facility that will pay out in the event of a sudden collapse in the exchange rate. A third is to make it easier for international bodies to lend to sub-sovereign entities such as municipalities. The IFC's Mr Woicke, who was a member of the Camdessus panel, points out that 90% of water is provided by local entities, so he is especially keen on this plan. The IFC has recently made its first such loan, to a Mexican municipal water supplier.

Big cities in developing countries are certainly in need of reform. India offers some telling examples, one of the best being the capital, Delhi. Sumi Tripathi, chairman of the Delhi Jal Board, the municipal utility, proudly claims to deliver water to 86% of the 14m-strong population. Average consumption is 225 litres per day per head, comparable with levels in many rich western cities. Yet absurdly low prices, which cover only 4% of total costs, mean not only that much water is wasted or lost, but also that the board has too little money for investment. Local politicians will not allow water tariffs to be raised.

In fact, the situation in Delhi is even worse than this suggests. There are few water meters, and those that are installed soon break down, because they need constant, 24-hour pressure to function. Large parts of the city, especially the slums, get water for only a few minutes a day. Illegal tapping into groundwater is widespread, so the water table is falling fast. And because most of the cheap piped water goes mainly to better-off areas, as Sumita Dasgupta of the Centre for Science and Environment points out, the urban poor are, in effect, subsidising the urban rich.

The Delhi Jal Board has let a small private contract for waste-water treatment, even though local politicians in India are generally against using the private sector to improve their utilities. But if the Johannesburg goals are to be met, the private sector's skills in water will have to be harnessed in some way. Most important of all, private involvement—or the threat of it—can be an effective method of forcing reform on bloated and corrupt municipal utilities. As the Camdessus report puts it, “The prospect of private-sector participation in its various forms can be a powerful spur to the reform of public water agencies, whether it actually happens or not.”

But if water supply is to be improved, that will also mean tackling the green lobby's other big bugbear: dams.

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Savoir faire

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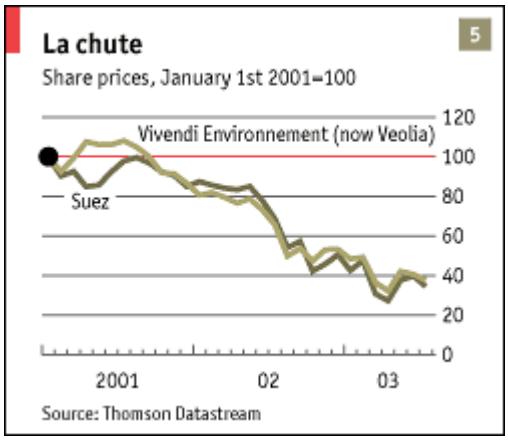
French companies dominate the world's water industry



IT IS a nice irony that in the United States, the great champion of free-market capitalism, almost all the water is delivered by the public sector, whereas in France, one of unbridled capitalism's sternest critics, water has been provided by private companies for 150 years. The two biggest are Générale des Eaux, now owned by Veolia, with 25m domestic customers; and Lyonnaise des Eaux, now owned by Suez, which supplies 14m.

Générale des Eaux was established by Napoleon III in 1852, partly to finance water connections off the state's balance sheet (the motive that also spurred Margaret Thatcher's water privatision in Britain in 1989). Its first contract was to supply the city of Lyons. Oddly, Lyonnaise des Eaux, set up in 1880, has never supplied Lyons—its name stems from its sponsorship by the bank, Crédit Lyonnais. Following the 19th century model, the standard contract for these companies is known as *affermage*, in which the ownership of the water assets is in municipal hands but their management, operation and maintenance is contracted out.

The two companies dominate not only France but the water industry worldwide. Only RWE/Thames comes anywhere near them. An American attempt to beat the French at this game failed when Azurix, part of the failed energy-trading giant Enron, went into oblivion. Instead, it is the Europeans that dominate America: through its ownership of US Filter, Veolia is the biggest private waste-water firm there, and RWE/Thames's ownership of American Water Works makes it the biggest private water supplier in America.

The French giants' bosses, Gérard Mestrallet of Suez and Henri Proglio of Veolia, are, unsurprisingly, firm advocates of the French system. “We are not in favour of the British model,” Mr Proglio says baldly. “We are not water merchants; we never own the water,” explains Mr Mestrallet. Both men insist that water has to be properly priced. In Mr Mestrallet's words, “Water is free, but the service is not free.” Mr Proglio says that pricing is more important than whether water is publicly or privately supplied. He tells the story of Montreal, which has so much water that it does not charge by volume. This has pushed leakage rates up to 53%. To meet rising demand, the city is investing in another reservoir that is not really needed.

When it comes to developing countries, however, both companies have suffered. Suez is retrenching most, pulling back in both Asia and Latin America. Veolia has been less troubled, partly because it has concentrated more on America and eastern Europe. Both companies hope for a prosperous future in China. Sadly, neither is much interested in sub-Saharan Africa, where the need for water is greatest—though a third French company, Saur, owns the private utility supplying water to Abidjan, Côte d'Ivoire.

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Damming evidence

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The pros and cons of big earthworks

THERE is something majestic about a giant dam. When Franklin Roosevelt opened the Hoover dam in 1935, he was spellbound: “I came, I saw, and I was conquered.” The Hoover was the biggest concrete structure on earth; until the late 1950s it remained the world's tallest dam. Even such a diehard opponent of dams as Patrick McCully, of the International Rivers Network in Berkeley, California, admits shyly that he rather likes this particular one. The Hoover was only the first of many large dams in America. It was followed by such examples as the Grand Coulee on the Columbia river, the Shasta dam on the Sacramento, a string of dams across the Missouri and the Tennessee rivers, and the Glen Canyon dam, above the Hoover on the Colorado.

EPA

Dam fans make a splash

Other countries followed eagerly in America's wake. Pakistan has the Tarbela dam on the Indus, India the Bhakra dam in Punjab and the Sardar Sarovar on the Narmada river. Spain has a long history of big dams, as does Switzerland. Turkey has several huge dams on the Euphrates and is now building more, much to the annoyance of its downstream neighbours, Syria and Iraq. Japan has dammed as many as 90% of its rivers. Tajikistan boasts the world's tallest dam, the Nurek. Egypt has the Aswan High dam, paid for with Soviet money in the 1950s. South America is littered with dams, led by the world's biggest, the Itaipu on the Brazil/Paraguay border. Even sub-Saharan Africa has got in on the act, with the Kariba dam in Zambia, the Bujagali dam about to open in Uganda and several big dams in South Africa.

But the world champion is China, with some 22,000 large dams. That is almost as many as the rest of the world put together. The runners-up to China are the United States (6,600), India (4,300) and Japan (2,700). The Yellow river, one of the world's muddiest, is repeatedly dammed, most recently by the Xiaolongdi dam; today the Yellow often does not reach the sea at all. China is also responsible for the world's biggest dam disasters: a series of dam failures in 1975 killed as many as 230,000 people. Last month, China began to fill the reservoir behind what will be the world's biggest and undoubtedly most controversial dam, the Three Gorges across the Yangtse river, due to be completed in 2009.

Big dams may seem popular, but they are also bitterly resisted. As John Briscoe, the World Bank's principal water adviser, puts it, lending for big dams accounts for about 10% of the Bank's portfolio but 95% of its headaches. The list of charges against dams is long. By blocking a river's flow, they prevent silt reaching the lower basin. This can cause soil erosion, and also means that reservoirs behind dams fill up with mud, limiting their lifespan. Big dams stop anadromous fish, the best-known of which are salmon, returning to their spawning-grounds to breed. Reservoirs often flood forests, which give off

methane and other greenhouse gases as they decompose. Above all, big dams displace thousands (in China, millions) of people, who are seldom properly compensated.

The economics, too, are often questionable. Big dams are prone to cost overruns: as much as 30% on average, calculates Mr McCully. The irrigation gains they produce may be more than offset by the loss of the fertile land they inundate. Supposed recreational benefits are often hugely overstated. The costs of resettling people are not fully accounted for. And even the hydropower that big dams offer is less useful than their builders claim. Because dams do not last that long, say greens, it is wrong to treat such energy as renewable.

Big dams have long been a favourite target for green activists. Edward Abbey's “The Monkey Wrench Gang”, the classic novel about fighting dams, tells of a hardline environmental group that sabotages dam-builders along the Colorado. Two dams have become particular symbols of resistance in America: Glen Canyon on the Colorado, completed in 1966 in the teeth of environmental opposition; and Hetch Hetchy, in California's Yosemite national park, resisted by the father of modern environmentalism, John Muir, who founded the Sierra Club, the first green NGO. Today's greens live in hope that both will be torn down.

Not in our back yard

In developing countries, too, the backlash against dams has been strong. India's Sardar Sarovar dam ran into a storm of opponents, including Arundhati Roy, a Booker-prize-winning novelist. It was completed only after a succession of court judgments. The Aswan dam was popular in its day, but many Egyptians now regret having built it. The Three Gorges dam has generated green hostility not just globally but even within Communist China.

Why, in the face of such resistance, do governments still build large dams? There are two answers, one bad and one good. The bad one is that no politician can resist the prestige linked to a big dam. Visiting India's Bhakra dam in 1954, Jawaharlal Nehru, an icon of political correctness, asked: “Where can be a greater and holier place than this?” *Sotto voce*, lesser politicans like the kickbacks, too. In the 1950s and 1960s, American congressmen vied with each other to authorise costly water projects; the rival builders, the Army Corps of Engineers and the Bureau of Reclamation, competed to provide dubious cost-benefit analyses to support them. They even built dams in wholly unsuitable places: as hydrological engineers had predicted, the Teton dam in Idaho collapsed within weeks of completion in 1975.

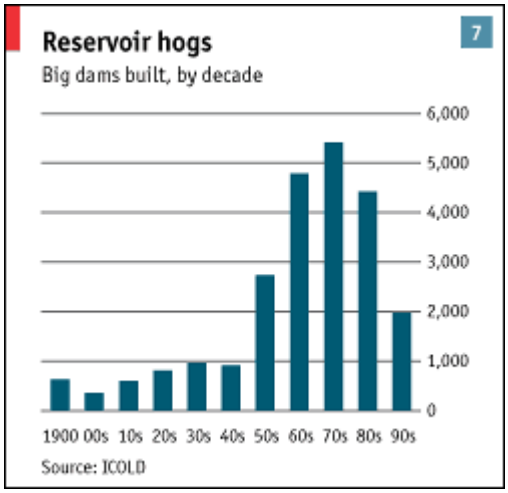
The good answer, however, is that large dams can bring substantial benefits. Besides irrigation, which for all its drawbacks has been vital to the success of agriculture in such diverse places as California, Pakistan, India and China, there is flood control. Tell a Chinese official you think the Three Gorges dam is objectionable because it will displace millions of people, and he will remind you of the millions through history who have died in Yangtse floods—or of the 3m-plus killed in floods along the Yellow river over the past three decades. Moreover, many of the bad consequences of dams can be avoided if the right policies are followed: silting can be slowed by sensible water releases, forestry inundation prevented by clearing trees, salmon accommodated by building fish ladders, people resettled in better places, and so on.

And then there is electricity. Hydropower accounts for a fifth of the world's electricity. The International Hydropower Association maintains that its use has saved the consumption of 22 billion tonnes of oil. Some 64 countries depend on hydropower for more than half their electricity. The electricity generated by the Grand Coulee in the early 1940s helped to win the second world war, because it made possible the manufacture of huge numbers of aircraft in the Seattle region. The Itaipu dam generates 12,600MW of power a year. The Three Gorges will supply almost a fifth of China's power needs; the alternative would have been to burn a lot more coal. Renewable or not, hydropower is certainly greener than most other sources of energy.

Is it possible to reconcile the arguments of antis and pros? That is what the World Commission on Dams set out to do when it reported its conclusions in November 2000. The commission brought together greens, dam-builders, financiers and officials. Its report dispassionately set out the arguments for and against big dams. It stopped short of suggesting a moratorium on new construction, but proposed 26 guidelines for dam-builders, covering such matters as respect for the environment, consultation with local people, proper plans for the displaced, and a genuine cost-benefit analysis.

The number of big dams built has fallen in recent years (see chart 7). The World Bank's lending for dam-building has declined from

some $1 billion a year in the early 1990s to little more than $100m last year. Yet many governments, and indeed many World Bank officials, remain unhappy with the WCD's guidelines. They reckon that, if followed literally, these would make it all but impossible to build another big dam. Under pressure from its Chinese and Indian executive directors, the Bank's new water-resources strategy, released in February, backs away from the WCD report. The Camdessus report on financing the Johannesburg goals barely mentions it. The mood is summarised by Ian Johnson, a vice-president of the Bank, who says his institution wants to lend for dams again, and complains that "NGOs say there is no such thing as a good dam or forestry project."



In truth, the anti-dam brigade's arguments are laced with hypocrisy. In rich countries, where most lobbyists live, large dams in the obvious places have already been built. Ronnie Kasrils, South Africa's water minister, points out that the United States has 7,000 cubic metres of water-storage capacity per head; South Africa has 700; the rest of Africa has 25; and Kenya has but four. Ethiopia has exploited perhaps 3% of its hydropower potential, compared with Japan's 90%. Mozambique's catastrophic floods in 2000 strengthened the case for more dams to contain them. The rich world has certainly built too many dams, which would be a costly mistake for poor countries to copy. But there is a good case for more dams in Africa.

Moreover, if the World Bank and other international agencies, cowed by the greens, were to fight shy of financing big dams, many bigger countries would simply go ahead on their own. Today's two biggest dam-builders, China and India, are doing just that (no World Bank money went towards the Three Gorges), as are Turkey and Brazil. When countries are left to their own devices, it is a racing certainty that their dams will involve more kickbacks and corruption—and that they will ignore the WCD guidelines altogether.

Streams of consciousness

If dams are controversial, full-scale river diversions are political dynamite. The two often form part of the same project, but diverting an entire river arouses still more green hostility. Rivers have huge emotional appeal, reflected in song and story: think of the Blue Danube or the Moldau, of Old Man River or Father Thames, of the Volga boatmen or the Rhinemaidens.

Water transfers between river basins are as old as the Romans—that is what most aqueducts were for. Such transfers can have adverse environmental consequences, though they can also bring environmental benefits. But some plans are so huge that the potential risks become daunting. Examples include Nawapa, a stillborn American proposal to divert rivers from British Columbia to California, or an even madder Soviet-era plan to divert the Ob and Lena rivers from north to south. Even so, two countries, China and India, plan to go ahead with massive river-diversion projects.

China has long fretted about a growing water shortage in the country's north. Officials say that some 400 of the country's big cities are short of water, with 110 seriously deficient. Most are in the north. The Three Gorges and dams along the Yellow river will help. But the ultimate solution now being proposed is a water transfer from south to north. Hence the revival of a plan first mooted by Mao Zedong 50 years ago: a series of canals and aqueducts to transfer water from the Yangtse to the Yellow river basin. The project, approved by the Chinese cabinet in November 2002, is expected to cost some $50 billion, more than twice as much as the Three Gorges.

Even China's huge scheme, however, pales into insignificance compared with what India is planning. The Indian government wants to interlink almost all the countries' rivers, at a cost currently put at some $120 billion. Curiously, it is doing this not in response to political pressure but because the Supreme Court ordered the government to look into the feasibility of such a scheme, after which the prime minister set up a task-force.

The minister in charge of this, Suresh Prabhu, notes that India has 2.2% of the world's land and 4% of its fresh water, but 17% of its population. By 2050 India will have 1.5 billion people. He admits that measures will be needed to restrain demand, and even concedes a role for higher prices and for rainwater harvesting. But none of this will be enough. In response to opponents of the interlinking

project, Mr Prabhu insists that the government is conducting an environmental analysis of unprecedented thoroughness. He also claims, optimistically, that the annual cost of the project, which he hopes will be largely completed by 2016, will be equivalent to less than 1% of GDP.

The Indian interlinking plan is running into massive opposition. Greens point to its huge cost, and note that Indian states cannot agree how to control shared rivers even now: Karnataka and Tamil Nadu have almost come to blows over the Cauvery. It is hard not to conclude that it would be cheaper and more efficient for both India and China to clean up polluted water, curb demand by pricing water more realistically—and, *in extremis*, move people rather than water.

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Irrigate and die

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Underpricing and misallocating water carries a high price

PRIVATISATION and dams may arouse great passion, but mispricing of water has far more serious effects. In truth, the story of water almost everywhere involves abuse, waste and even tragedy. Nor are things getting better: indeed, much of the worst damage has been wrought in the past 100 years. Water resources have been exploited with no heed either to sustainability or to the environmental consequences. And water policy has suffered from a near-total disregard for the discipline and tools of economics, especially pricing, trading and cost-benefit analysis. These failings are best illustrated by looking at irrigation for farming, which has always consumed the lion's share of available water.

Irrigation catastrophes have befallen civilisations since the dawn of time. Archaeological evidence suggests that much of the Sahara was once a green and pleasant land, until depletion of groundwater turned it into desert. The Maya civilisation in Mexico is thought to have ended because of a sudden drought. In what is now Arizona, Hohokam Indians developed a remarkably sophisticated irrigation system. But too much irrigation waterlogs the ground, and when the water evaporates it leaves salts behind. Just such a lethal salinisation seems to have overtaken the Hohokam, who died out suddenly in the early 15th century. Sandra Postel, author of “Pillar of Sand”, a book about irrigation, maintains that, with the single exception of Egypt, no civilisation based on irrigation has survived for long, either because the water has run out, or because of silt, or because of salinisation.

Yet it is modern engineering that has made possible irrigation disasters on a massive scale. The saddest is the tale of the Aral Sea, once the world's fourth-biggest inland sea. In the 1950s Soviet planners, following Stalin's 1929 dictum that “water which is allowed to enter the sea is wasted”, diverted large parts of the two rivers that feed the Aral, the Amu Darya and the Syr Darya, to irrigate cotton crops in the near-desert terrain of central Asia.

The Aral soon started to dry up. Since 1960, it has shrunk by three-quarters in volume (see map). Almost all the fish have died out; a once-thriving fishing fleet that had supported several villages has disappeared. Moreover, rapidly rising salinity has killed many crops, and salt in the air has damaged local people's health, increasing the incidence of cancers and respiratory diseases. All this for a few million tonnes of heavily subsidised cotton, produced at the insistence of a regime that collapsed more than a decade ago. The Aral Sea may never recover, though its shrinkage seems to have slowed recently.

Soviet central planners are not the only culprits. In Iraq, Saddam Hussein notoriously drained the marshes of the lower Tigris and Euphrates, home of the Marsh Arabs and possibly the site of the original garden of Eden. But big water projects for agriculture have had unforeseen malign consequences in rich countries too. The history of the American west, for example, is one of overexploitation of limited water resources, mainly for the benefit of farmers, at huge cost to federal and state taxpayers and with severe environmental side-effects.

Cowboys and Indians

The classic account of water in the American west is Marc Reisner's book “Cadillac Desert”. When the west was settled in the late 19th century, much of it was desert or semi-desert. But instead of encouraging settlers to adapt to this climate by, for instance, dry farming, the government decided to

bring water to them. This involved building a series of gigantic dams, as well as putting in hand huge water-diversion projects, fed by dams, or by siphoning water from the Colorado and other rivers, or by tapping groundwater. The Colorado's annual flow was “allocated” among the upstream and downstream states in a 1922 compact. Not only did this account for all the water in the river, in line with the prevailing principle of not “wasting” water; because the numbers were based on several unusually wet years, it allocated more water than is normally available.

The biggest water projects of the 20th century were all in California. The most gigantic of them all is the Central Valley Project, a vast system of dams, pipes and channels that supplies irrigation water to the farmers of the central valley at a tiny fraction of its cost. Together with the State Water Project that ran alongside it, this made California's agriculture into one of the most productive in the world, the backbone of the state's economy. But it also entrenched lavish subsidies and polluted the Sacramento-San Joaquin river delta. The worst example is the leaching of selenium into Kesterson reservoir, where it has caused grotesque deformations in birds.

Next in scale was the diversion of Colorado river water to the Imperial valley irrigation district in southern California. The Imperial valley now uses a fifth of the Colorado's water (some two-thirds of what California is entitled to take from the river), mainly to grow such thirsty crops as alfalfa, rice and cotton. Indeed, half of California's water is now used for crops that are better suited to a wet environment than to a semi-desert.

Another staple of the American west is groundwater depletion. The dustbowl years of the 1930s drove many mid-western farmers off the land, but the discovery of the Ogallala, a huge underground aquifer stretching from South Dakota to west Texas, transformed agriculture's fortunes. Now, thanks to intensive pumping, the Ogallala aquifer is being depleted at a rate eight times faster than it is being replenished. It could run out before the end of this century. What will the mid-west do for water then?

The entire western water business is bedevilled not just by “water buffaloes”, anxious to keep their subsidised water, but by lawyers. The intricate network of western water rights, some riparian and some based on first use, is absurdly complex. Successive court decisions have established that the claims of Indian tribes take precedence over those of subsequent settlers. There are said to be more water lawyers in Denver than in the rest of the world put together. In truth, the west is living up to Mark Twain's famous dictum that “whiskey is for drinking; water is for fighting over.”

Things are not much better on the other side of the United States, in southern Florida, where the Army Corps of Engineers has dammed, leveed, straightened and engineered all the rivers that flow through the Everglades national park. Sadly, the corps never understood that the entire Everglades region was really a single, slow-moving river, so all its taming of the waters has in fact served to undermine the park's fragile ecology. Now the corps is engaged in an even more costly project to put right the evils of its own engineering, including restoring bends to the Kissimmee river and removing infrastructure—and many experts say this restoration will not work.

Much of the benefit of the huge investment poured in has gone to provide irrigation water for southern Florida's rich and heavily subsidised sugar growers. America's sugar regime is already outrageous enough, keeping sugar prices at three times world levels and blocking imports from some of the world's poorest countries. This egregious irrigation scheme compounds the folly by destroying the Everglades as well. When it comes to water politics, no Soviet central planner could have done worse than America.

The developing world is just as capable as is America of pursuing disastrous irrigation policies, but it is much less able to afford them. The Indian subcontinent, for example, has plenty of water, but in the wrong place or at the wrong time. India offers some excellent general lessons in how not to organise water. As Sumita Dasgupta, of the Centre for Science and Environment in Delhi, sums it up: “The problem is water management, not water scarcity.”

Scarcity amid plenty

Thus Cherrapunji, north of Bangladesh, is officially the wettest place on earth, and yet suffers frequent water shortages. In Bangladesh itself, watered by two of the world's biggest rivers, the surface water is so badly polluted that many farmers and cities rely on groundwater. However, the groundwater contains so much arsenic that it is maiming and even killing consumers. This problem has also led to a lawsuit against the British Geological Survey, which failed to test for arsenic when it checked the groundwater in the 1960s.

Much of rural India is also a microcosm of appalling water management. Many farmers get their irrigation water free. Many also benefit from free electricity, which sets up a noxious interconnection between free water and free power. As much as 60-70% of mostly free rural electricity is used to power hundreds of millions of inefficient pumps, which are being used to deplete India's already scarce groundwater. Water and electricity are both the responsibility of the states, not the central government, and bear a large share of the blame for India's huge fiscal deficits. And the main beneficiaries of this largesse, inevitably, are richer farmers, not poor peasants.

The Middle East, one of the most arid regions of the world, also offers some sorry irrigation stories. Israel has become a pioneer of drip irrigation, which is far more efficient than the usual flood irrigation, but in recent years it has been deliberately increasing the amount of water it takes from the Jordan river as a bargaining chip in peace negotiations.

Saudi Arabia, meanwhile, is depleting fossil groundwater and desalinating sea water to provide irrigation for the extraordinary purpose of growing wheat. It takes 1,000 tonnes of water to grow one tonne of wheat, and the true cost of Saudi wheat is estimated to be as much as 100 times the world price. It would be far more efficient, and much cheaper, for a dry country such as Saudi Arabia to import wheat. As Tony Allan, of London's School of Oriental and African Studies, has argued, this would amount to the same thing as importing water, but at far lower cost. He calls such trade “virtual water”, referring to the water consumed to produce food.

Desalination to provide water for agriculture is almost always economically inefficient because the process consumes so much energy. However, the costs of desalination have fallen to the point where it is becoming viable for domestic water supplies. In places such as Bermuda, San Diego and St Petersburg, Florida, desalination already supplies a share of drinking water. Desalination will grow—but it will only ever be a small part of the answer to the world's water problems.

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Liquid assets

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Where to look for sensible water policies

NOT all the world's water policies are terrible. There are successes too, in such widely differing fields as pricing, irrigation and improved access. There are even moves to start rectifying past failures. The most encouraging places are Chile, South Africa and Australia. India, for all its faults, is pioneering the revival of low-cost rainwater harvesting (see article). And even California, which has pursued the worst water policies of them all, is trying to put some of them right.

As on other economic and social issues, Chile has succeeded where the rest of Latin America has largely failed. It now has near-universal water-supply and sanitation coverage. Aguas Andinas, the utility that supplies Santiago and its region, has successfully let a contract to Suez that has survived exchange-rate problems. The country has also enforced proper pricing for water. Rather than dishing out blanket subsidies to hold down water tariffs, a policy that usually benefits the middle classes most, Chile charges everybody the full cost of their water, but gives poor people stamps to redeem against their bills.

More instructive for most developing countries is South Africa, an arid country bedevilled by water shortages. Under apartheid, the government concentrated on serving the white minority and largely ignored blacks, especially in rural areas. Ronnie Kasrils, South Africa's water minister, notes that when the African National Congress took over in 1994, some 14m South Africans, a third of the population, had no access to clean water. Now some 9m of those 14m have been connected, and Mr Kasrils promises universal coverage by 2008. Connection means piped water in cities or a working standpipe within 200 metres of every home in villages.

How has South Africa done it? Mr Kasrils naturally points to strong political commitment by the government. His predecessor in the job, Kader Asmal, fought hard for the necessary cash. But perhaps more important was a new South African water law, passed in 1998. This put the government firmly in charge of the country's water, abolished previous riparian rights, made water allocations both temporary and tradable, and required full costs to be charged to all users except for the very poorest. To deal with this last point, Mr Asmal hit on a two-tier pricing policy: the first 25 litres per day, regarded as a reasonable minimum, were made very cheap, but beyond that the price rose sharply.

Mr Kasrils has since modified this scheme to make the first 25 litres completely free. He justifies this by pointing to women in rural areas who would rather walk for seven hours to take water from the river than pay anything at all. And he talks of a water “ladder”, with users getting used to the idea of paying beyond a minimum quantity, so that water charges become more acceptable. No ideologue, Mr Kasrils also sees a role for the private sector: five South African municipalities have let private contracts. In response to critics within his party, the minister points out that even Fidel Castro's Cuba uses the Suez-owned Aguas de Barcelona.

Down under on top

The country that takes top prize for sensible water management, however, is Australia. Not only is it the driest inhabited continent on earth, it also has one of the biggest variations in rainfall. Until the 1970s, Australia followed the example of the American west, building a string of dams and subsidising water for farmers. Over the past decade, however, it has radically transformed its water policies, putting much greater emphasis on pricing, trading and the use of the market.

The starting-point was a clear separation of water rights from property rights. Water belongs to the crown, and users are given only access rights by the government. Irrigation, notes Don Blackmore, chief executive of the Murray-Darling Basin Commission, which covers the main population centres of Australia, gobbles up almost 90% of the region's water. Once access rights were clarified, a system of

trading was introduced, with Victoria leading the way. Trading now crosses state boundaries too; there are even two computerised water exchanges. And there are the beginnings of trades between farmers and big cities. Mr Blackmore suggests that Adelaide will have to buy water from farmers, as it has hit the cap on what it can take from the Murray-Darling. The basin is also tackling its growing salinity problem imaginatively, by instituting a trade in salt credits along the lines of America's trade in greenhouse-gas emissions.

Mike Young, an economist at CSIRO, an environmental think-tank in Adelaide, and author of a study of water trading, “Robust Separation”, identifies two other crucial features of Australia's trading system. One is that it is measured in net terms—meaning that it takes account of return flows to the river that farmers do not use. The second is that it factors in environmental demand and changing land use. Allowing enough water for the environment avoids the mistake of allocating too much to people. Mr Young also notes that temporary trades, depending on season and weather conditions, are more valuable than permanent ones, because they ensure that water can easily be reallocated to the most efficient use.

On the domestic front, too, Australia is a pioneer. Claude Piccinin of the Water Services Association of Australia points out that the country has 100% water metering, so it can charge by volume, not just for access. The federal government's water reforms encouraged charges based on full-cost recovery, including all environmental costs. Mr Piccinin says his member utilities are now looking at pricing again. They are thinking about shifting to charges based wholly on quantities consumed, varying prices according to season, adding the full cost of waste-water treatment, and maybe bringing in a stepped structure, similar to South Africa's, in which the price increases with the volume consumed.

Australia has managed all these reforms largely within the public sector, preferring to talk of “corporatisation” rather than privatisation. Warren Truss, the federal minister responsible, observes that there is a lot of resistance to full privatisation, although both Adelaide and Canberra have given a small role to private providers. Mr Truss adds that water reform needs to be set in the context of the country's overall economic reforms of the past decade; and he reckons that the country still has a long way to go to get its water policies right. But he has been able to use the lure of federal “competition payments” to states to persuade them to co-operate in his reforms.

California dreams

Perhaps the most surprising convert to more intelligent water policies is California. According to Henry Vaux, professor of resource economics at the University of California and president of the Water Education Foundation, “We have learnt no longer to talk of wasting water to the sea.” He is also enthusiastic about the use of proper pricing and water markets to improve water allocation. The process of reform began with the 1973 Endangered Species Act, which made it harder to build new big dams. But the real watershed was the 1992 passage through Congress of the Central Valley Project Improvement Act (CVPIA). Tom Graff of Environmental Defence, a green lobby group, hails the CVPIA as the first-ever defeat for the state's powerful farm lobby.

The CVPIA not only steeply raised irrigation charges to farmers; it also, for the first time, put the needs of the environment into the equation. Following its passage, all the actors in the Californian water drama came together to form CalFed, a project dedicated to restoring the San Joaquin/Sacramento delta, improving fisheries and cleaning up pollution. Mr Graff reckons that all the millions spent under CalFed have in fact bought little. Yet Patrick Wright, who supervises the project from Sacramento, retorts that CalFed is a huge improvement on the gridlock of California's water politics in the early 1990s. Mr Wright says CalFed is the biggest restoration project in the country after the Everglades in Florida.

The most interesting development in California, as in Australia, is water trading. This is not a new phenomenon. In Spain, the medieval water court that still meets in front of the cathedral in Valencia was set up to supervise trades in irrigation water among farmers. In Gujarat, India, informal water trades between farmers have gone on for centuries. Chile also has a well-organised system of trading in water among farmers.

In California, Tim Quinn of the Metropolitan Water District of Southern California likes to take the credit for negotiating the earliest trading deals. He concedes, however, that farmers remain suspicious of “the Owens valley syndrome”. The Owens valley lies high in the Californian mountains 250 miles north-east of the city of Los Angeles. The “theft” of its water by William Mulholland and his fellow water barons in the early 20th century has become the most notorious water grab by any city anywhere, depicted in such movies as “Chinatown”. The result was not only that the farmers of the Owens valley lost their water. Far

more serious, the whole experience has poisoned subsequent attempts to persuade farmers to trade their water to thirsty cities. Several Californian cities now pay a price for their water that is several times higher than what the federal government charges its heavily subsidised farmers.

Even now, a long-proposed water trade between Imperial valley irrigators, with their historic rights to Colorado river water, and fast-growing San Diego remains mired in political and legal objections, and San Diego has had to build yet another dam instead. This example shows that it is critically important to get local politics right, and to trade not permanent water rights but, for instance, options that can be taken up if necessary. A California Water Bank has been set up to facilitate trading.

California (and America as a whole) still has a lot to do to catch up with more progressive water planners such as Australia, but at least reform has started. A complete overhaul of the country's water-rights laws would be a helpful step. So, in the West, would tearing up the 1922 compact on the allocation of Colorado river water among the states. Sadly, both ideas are likely to remain stillborn.

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The water man

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An ancient practice revived

RAINWATER harvesting seems as obvious as putting a barrel in your back yard. In the more arid regions of India, however, it involves bigger projects than mere barrels, stretching to quite significant dams, underground tanks and reservoirs, often of great antiquity. That is why there is such interest in the revival of rainwater harvesting in Rajasthan, led by the charismatic Rajendra Singh, known as the water man.

Mr Singh's organisation, Tarun Bharat Sangh, based in a tiny remote village near Alwar, has attracted visits and support from the World Bank, the UN and USAID, America's development agency. The atmosphere inside the whitewashed compound is almost temple-like: Mr Singh brings all the fervour of a religious zealot to his mission. His team goes out to find and re-open ancient tanks and underground storage facilities, as well as getting villagers to build new ones. This work, he claims, has allowed well over 1,000 villages in eastern Rajasthan to escape the effects of a five-year drought. His structures also offer protection from the dangers of floods, such as the one that struck in September 1996, the last time it rained heavily in the area.

Mr Singh is opposed to most of the Indian government's ideas for solving the country's water problems, including dams, the “very dangerous” project for interlinking of rivers, and privatisation. Last year he was attacked and badly beaten for his stance at a workshop meeting in Uttar Pradesh. He prefers the notion of “communitisation”—getting local communities to deal with water shortages by building and maintaining their own water tanks and other structures, usually giving their labour free. Nor is rainwater harvesting just for rural areas, he says: it can also be used in big cities and in other countries. He claims that in Rajasthan alone there are 7,600 examples. Even the Delhi Jal Board promotes rooftop rainwater harvesting.

It would be fanciful to suggest that rainwater harvesting can resolve all water problems. It is harder in big cities, and if too much is collected not enough water may reach rivers or replenish groundwater supplies. But it has a role to play. Perhaps above all, it offers a useful lesson in the benefits of treating water as a local issue, best dealt with by local communities.

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To market, to market

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A price for everything

SO WHAT is the right answer for water? It starts from three propositions. The first is that there is no imminent water crisis arising from ever-growing consumption that could lead to terrible shortages or even wars. Second, past policies, based on predicting demand and building big, centralised and costly water projects to meet it—what Peter Gleick of the Pacific Institute calls the “hard path” for water—are no longer sensible. The third is to stress that, although water is special, both its provision and its use will respond to economic and market signals. That opens up what Mr Gleick, borrowing from Amory Lovins of the Rocky Mountain Institute, calls the “soft path” for water, based more on demand management and low-cost local provision than on engineering.

Demand management is a popular green notion. But most environmentalists use the term only to berate the rich world for wasting water, in the same way as it does energy. Greens dislike making the connection between demand management and water pricing. For domestic and industrial consumers, it requires metering and a charge based on consumption by volume. Charges should be set, as far as possible, to cover full costs, including environmental ones.

It is often claimed that the poorest cannot afford to pay, so prices in developing countries need to be a lot lower. But there are two powerful arguments against this. The first is that, in many developing countries, the main beneficiaries of low water prices are not the poorest but the middle classes, because it is the middle classes who have access to piped water. The poorest often pay far more to private water vendors (see chart 8). Second, setting prices too low (or, worse, making the stuff free) removes the incentive to use water wisely. When more investment, public or private, is needed to improve water access and sanitation, low prices provide insufficient income to help repay the capital costs. This does not rule out subsidies for poor consumers, but they have to be better targeted. The Chilean idea of giving water stamps to poor people to meet their bills is one option; the South African one of providing a basic minimum quantity of water cheap or free but imposing higher charges for greater consumption is another.

The next big issue is irrigation water, which accounts for three-quarters or more of consumption in most developing countries. In some countries, irrigation water is provided free, even though the dams, canals, tunnels and pipes that are needed to supply it can often be among a country's biggest and most costly infrastructure projects. Where it is not free, charges tend to be absurdly low. A sensible start would be to get farmers to see water as something that has to be paid for.

Price can encourage more efficient use of water, such as the use of drip irrigation: in the popular phrase, to get “more crop per drop”. Less than 1% of the world's irrigated farmland employs this system, yet it can achieve an efficiency level of 95%, compared with only around 60% for flood irrigation. But it is unrealistic to expect farmers in, say, India or Pakistan to switch overnight to the best drip-irrigation methods as used in Israel. Nor is it politically plausible to suggest that farmers must always pay the full cost of their water. Water for irrigation is highly price-inelastic: since farmers have little alternative but to use the stuff, charging the full cost could simply drive them into bankruptcy.

A fair exchange

The best solution is water trading. In many ways, what matters for irrigation water is not that prices should cover full costs, but that it should be used efficiently. In economic terms, the opportunity cost of the water (ie, its value to another party) is usually far greater than the actual cost. To make trading work, two big steps are needed. The first and most important is to define and clarify water rights. Water, as a public good, should be a responsibility of government; its allocation to users should be made a contractual entitlement that is both temporary and tradable. Once this is done, farmers (and others who withdraw water) can be encouraged to trade, first with each other, and then, probably less often, with urban or industrial users. The best example of trading in action is in Australia, in the Murray-Darling basin. California too has set up markets in water. In both cases, the first result is to shift the use of water to crops with higher added value. But further ahead, there is the possibility that thirsty cities may be able to buy subsidised water from farmers.

Proper pricing and the encouragement of water trading are far more important than the topics that feature most often in international meetings: privatisation and dams. On privatisation, it is important to be clear what this means, for there is never any question of selling a country's water supply to a private company. A more accurate term is public/private partnerships, in which a private company signs a contract with a government agency to supply services—water delivery, waste-water treatment, sewerage or construction work. The private contractor will always have to be closely regulated over such matters as price, quality and service delivery. Subject to these safeguards, it makes sense for countries to use the private sector, especially in places where public-sector provision has fallen short.

As for dams, they loom large in the “hard path” to water, which is why rich countries in the 20th century were building ever bigger ones. Today, India and China seem to be going down the same route. There is a case for building dams (even big ones) in some places, notably Africa, although it needs to be done in a more socially and environmentally acceptable way and at lower cost. But it is almost always better first to use pricing and trading strategies to manage demand, and to allocate enough water to environmental needs. Dams should be a last resort.

As this survey has also argued, the success of water policies depends on governance. If private-sector involvement is to work, it needs strong and accountable regulation. Similarly, pricing and water trading depend on a robust legal framework defining water rights, and a reliable system for collecting payments. And water must be decentralised to local level. In rural areas, villages are often better at finding solutions than national governments; likewise municipal authorities in cities.

The Johannesburg goals of cutting by half the number of people without access to clean water and sanitation by 2015 are ambitious. Much of the discussion has focused on spending more money, especially foreign-aid money, to achieve them. Money will play a part. But economic and institutional reforms, and above all greater reliance on pricing and markets, are even more crucial.

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This survey has drawn on many published sources and interviews, not all of them cited in the text. Two useful reports published earlier this year are "Water for People, Water for Life", a report by 23 UN agencies; and "Water and Sanitation in the World's Cities" by UN-Habitat. The survey also drew on various OECD studies, notably "Improving Water Management: Recent OECD Experience" (2003). The Pacific Institute's biennial reports on "The World's Water" were also helpful. Among books consulted were "Cadillac Desert", by Marc Reisner (Penguin, 1987); "Last Oasis" and "Pillar of Sand", by Sandra Postel (Norton, 1997 and 1999 respectively); and "Silenced Rivers" by Patrick McCully (Zed Books, 2001). The author would like to thank the Water Education Foundation, in Sacramento; the World Bank, especially its water-policy adviser, John Briscoe; and HR Wallingford, especially Alan Hall.

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Jul 17th 2003
From The Economist print edition

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Economist.com BUSINESS
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Japan's energy crisis

Darkness falls on Tokyo

Jul 17th 2003 | FUKUSHIMA, ROKKASHO AND TOKYO
From The Economist print edition

AFP

Japan's electricity industry is in turmoil. This may have a big impact on the world's energy markets

WALK into the Ministry of Economy, Trade and Industry (METI), and you will find most of its lifts shut down, the corridors dark, and—although it is hot and humid—the air conditioners barely working. During the lunch hour, office lights are switched off, and on rainy days (this is Tokyo's rainy season, so there are plenty) bureaucrats can be seen straining to catch what little light comes through the windows as they work through their break. Sometimes offices get so dark that their solar-powered calculators stop working.

The ministry, which oversees the electricity industry, is gearing up for a power shortage that could leave Tokyo facing unprecedented blackouts this summer, when demand for electricity reaches its peak. The reason: Tokyo Electric Power (Tepco), the world's largest private electricity company, had to close its 17 nuclear reactors after it was caught last September falsifying safety records to hide cracks at some of its power plants. Three have now restarted, but it is unclear when the local authorities will allow others to do so.

As these nuclear reactors usually supply almost half the electricity for the region centred on Tokyo, Tepco reckons that it may fall short of expected demand by almost 10% this summer. It is begging the public to conserve energy. Companies such as Honda, Nissan Diesel and Toshiba have agreed to shift some of their factory operations to weekends or nights. Big shops, banks, brokers and even the Tokyo Stock Exchange are using dimmer light bulbs and setting air conditioners to higher temperatures. Workers face a sticky summer, though some bosses are letting them take off their ties. Sadly for bureaucrats at METI, its minister has decided that, as they also oversee the tie industry, they will not be allowed to do this.

Nuclear meltdown

Less well-known is that this summer's sweat may be a mere prelude to much worse problems. The electricity industry faces challenges that could undermine Japan's entire nuclear-power policy. Japan may then have to increase sharply its imports of oil, coal and liquefied natural gas, causing a surge in demand in world energy markets. With few natural resources of its own and one of the lowest energy self-sufficiency ratios among industrialised countries, Japan is already the second-biggest importer of oil and the biggest importer of natural gas. To illustrate the scale of what is involved, Kazuhiro Sakuma, an

analyst at Daiwa Securities SMBC, reckons that, if Japan closed its 53 nuclear reactors and switched entirely to oil (in practice, it would probably switch also to coal and gas), oil imports would rise by 30%.

Japan's nuclear reactors were built as part of an environmentally “clean” energy policy developed after the oil shocks of the 1970s. (They may also play a covert security role, giving Japan an option, subject to constitutional change, to use nuclear material for military ends.) Critics now liken this policy to “building a house without a toilet”, for there is no coherent strategy for disposing of spent nuclear fuel.

Nuclear power plants are running out of capacity to store the stuff. Japan used to send spent nuclear fuel to France and Britain to be reprocessed. But the latest contracts with these countries have ended, and the government has no plans to send more fuel abroad. It would face big political obstacles were it to try. America—which has considerable clout with Japan's government—might oppose the shipping of radioactive material halfway across the world on security grounds. Instead, the government is pinning its hopes on Japan's first big reprocessing plant, now being built by Japan Nuclear Fuel (JNFL), a consortium including nine of Japan's ten electricity firms, in Rokkasho, a village on the northern tip of mainland Japan.

Some nuclear power plants have only enough storage space for another two or three years' worth of spent fuel. Strict regulations bar transfers of spent fuel from one plant to another. The earliest a temporary storage facility can be built is 2010. Only if the reprocessing plant starts operating in July 2005, as JNFL insists it will, can nuclear plants avoid prolonged closure.

But as one bureaucrat in METI's Agency for Natural Resources and Energy admits, that is unlikely. Delays could last months, if not years. The ¥2.1 trillion ($17.5 billion) reprocessing plant is already six years behind schedule. Although most of the construction is now finished, only the first of four stages of testing has been completed. And this has raised more than 1,000 problems that need to be fixed.

Worse, the third stage of testing, using uranium, requires approval from local authorities. Yet JNFL recently discovered that one of the three pools used to store spent nuclear fuel, built by Hitachi, is leaking. Kenji Furukawa, the mayor of Rokkasho, insists that, until all leaks are repaired, the uranium test cannot go ahead.

Even then, the reprocessing plant may be unable to open unless the politically charged problem of what to do with the plutonium produced during reprocessing is solved. Normally this is combined with reprocessed uranium to make mixed oxide (MOX) fuel. In principle, this could be used in two ways. The one that would use up the most plutonium would be to deploy it as fuel in a fast-breeder reactor. Alas, Japan's efforts to develop the world's first commercial fast-breeder reactor were halted earlier this year by a court ruling criticising “serious and unforgivable mistakes” by the government over safety regulations at a prototype plant.

The second option would be to use MOX as a substitute for enriched uranium at existing nuclear plants. But this again requires local approval, and already some regional governments are refusing to allow the use of MOX on safety grounds. This follows a series of scandals, ranging from Tepco's cover-up and government failures to disclose safety problems, to data falsification by British Nuclear Fuels over tainted MOX shipped back to Japan, to a disaster when two workers died after using buckets to load a uranium-processing plant. Eisaku Sato, the governor of Fukushima, where Tepco generates 25% of its electricity, says his prefecture has scrapped all plans to permit the use of MOX fuel.

Add to this the vexed, and so far largely unaddressed, question of the cost of reprocessing, should it ever happen, and of disposing of the radioactive waste it generates. High-level radioactive-waste disposal costs alone, now estimated to be ¥3 trillion, could balloon, while other, as yet unquantified, disposal costs could add tens of trillions of yen more, declares Tetsunari Iida, a director at the Institute for Sustainable Energy Policies. Some electricity companies are said to be so concerned that they are privately reluctant for the reprocessing plant to start operating.

Japan's electricity prices are already the highest in the industrialised world, even without these extra costs. The outlook is further complicated by the government's plans to deregulate the market to lower prices, so as to help other industries become more competitive globally. Last month, parliament approved a bill that will deregulate electricity for all large and medium-sized users by 2005. Gas, steel and oil companies are entering the market, putting pressure on incumbents. Deregulating the market, but at the same time pushing nuclear power, which has high start-up and looming, unquantified back-end costs, makes no sense, says Hiroaki Fukami, a professor at Keio University.

If the incumbent electricity companies, as generators of nuclear power, have to foot the bill, they will pass these costs on to households, the only part of the market that will not be deregulated—resulting in a public outcry. Yet imposing some of the burden on new entrants would lead to price hikes across the board, defeating the purpose of deregulation.

One solution would be for the government to follow most others and nationalise the nuclear industry, or at least underwrite its long-term costs. Whether Japan's politicians will do this is debatable. So far they seem to be in denial that there is even a problem, at least in public, and, for the most part, in private as well. That they have already temporarily shut a large part of the country's nuclear industry once is a sign that they may be unable to avoid further temporary, or even permanent, closures in future—with nasty consequences all round.

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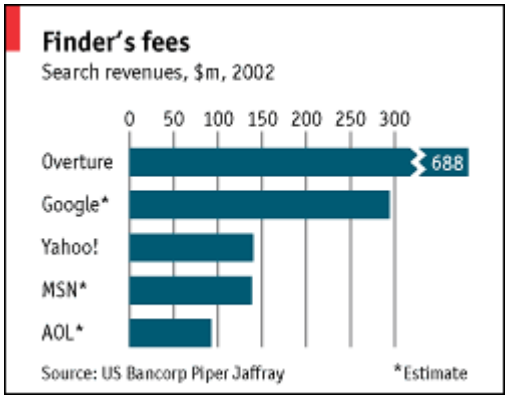
Internet advertising

Searching for relevance

Jul 17th 2003 | SAN FRANCISCO
From The Economist print edition

Yahoo!'s latest acquisition shows where online marketing is going



"WE DID this not for defensive but for opportunistic offensive reasons," insists Dan Rosensweig, Yahoo!'s chief operating officer, who is overseeing the acquisition of Overture, an online advertising firm, for $1.6 billion. Well, the deal, announced on July 14th, is certainly offensive—it challenges such rival internet portals as Microsoft's MSN, which is less popular and probably in even greater need of Overture. But its chief objective seems to be defensive: to pre-empt the stunning rise of Google, a search engine which, though not a portal, could soon rival Yahoo! as an online destination.

The ground being fought over is located on the results pages of internet searches. These, contrary to expectations during the dotcom boom, are now the most exciting place on the internet for many advertisers. A firm selling, say, digital cameras may forgo banner ads or annoying "pop-ups" and opt instead to be listed as a "sponsored link" on the page of results returned to a user who types the words "digital cameras" into a search engine. The advertiser pays only when a surfer actually clicks on their link (37 cents per click, on average).

Overture, launched in 1997 as GoTo.com, pioneered this advertising model, variously known as "paid search" or "pay-per-click". Its main service is as an auction room for advertisers, whose bidding determines how prominently their link is displayed. Overture then gives these lists to such clients as Yahoo!, and shares with them the advertising revenues once the clicking starts. The total paid-search market is now worth some $2 billion a year, compared with about $8 billion for other, more conventional online advertising, and it is growing furiously.

This explains the success of Overture, and also of Google, which last year launched a similar service (in its system, advertisers move up the list of sponsored links not only by bidding more money but also by getting more clicks). Overture considers Google's process sufficiently similar that it is suing for patent infringement. Other portals generally use one of the two as partners—MSN uses Overture, AOL uses Google, and so on.

In Yahoo!'s case, this was getting awkward. Relying on Overture for almost 20% of its revenues in the past two quarters, it had become too "dependent" on another firm, says Denise Garcia at Gartner, a research outfit. Yahoo! has also been farming out many of its searches to Google, which would leave it further exposed if their thorny relationship soured further.

Earlier this year Yahoo! bought Inktomi, a search engine that it could use to replace Google's technology. Buying Overture completes the picture. Rival portals may now find themselves in a weak position. (MSN, which uses Overture's service, will be even more reliant on Yahoo!, for example.) And it allows it to compete on more equal paid-search terms with Google. Yahoo! now plans to apply pay-per-click technology all over its portal—on its yellow pages, shopping pages and in news articles with related content—as it fights to be the most appealing online site.

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Regulatory follies

Overreach

Jul 17th 2003
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Are Swedes and NGOs dictating Europe's chemicals regulation?

TREE hugging is popular in Europe. So it is no surprise that the European Commission wants to tighten the regulation of European chemicals to promote cleaner living. But its current proposal is ambitious even by the EU's own lofty environmental rhetoric, dwarfing anything dreamt up by the bossy bureaucrats of America's Environmental Protection Agency.

The chemicals in question are not only the stuff of big, smelly factories, but those used in making everything from cosmetics to car parts. The draft directive, called REACH (Registration, Evaluation and Authorisation of Chemicals) extends oversight to at least 30,000 substances. The aim is to subject all chemicals in use before 1981—and so not covered by current rules—to a tough safety-testing regime.

European industry is in uproar. Chemicals firms say they support the goal of REACH to update laws that have failed to rid Europe of the nastiest substances. But this plan, they argue, is ham-fisted. It fails to focus on dangerous chemicals. Companies fear endless requests for data on almost any chemicals used. Small firms will suffer most.

Over a decade, the planned regulation will cost firms *euro*40 billion ($45 billion) in testing and other changes, according to one industry study. Some economic studies reckon that, over the decade, total European GDP will be reduced by 2-3% by the regulation—just what the EU's sickly economies don't need. No wonder even green-friendly Gerhard Schröder, with the governments of Britain and France, opposes REACH in its current form.

So who is in favour? The directive's most ardent backers are NGOs such as the World Wide Fund for Nature (WWF), Greenpeace and Friends of the Earth. They are increasingly politically-savvy and have couched their agenda in the language of “costs and benefits”. The WWF's British branch came out with an estimate that the savings on health care alone make REACH cost-effective, even though the precise links between most chemicals and diseases are not well established. As for macroeconomic consequences, the WWF says there is “no evidence” that tighter regulation will result in job losses, eg, because firms move out of the EU. They hope instead (also without evidence) that harsher regulation will spur innovation and jobs.

REACH is largely the brainchild of Margot Wallstrom, the environment commissioner, who comes from Sweden, a country that has been leading the fight against chemicals. With a minuscule chemicals industry of its own, the country has little to lose. Some critics say she is foisting Sweden's green policies on the entire EU, aiming to create a “chemical-free zone”. Most business leaders, however, are loth to criticise either her or the NGOs publicly.

The public consultation phase for REACH ended this week. Whether the commission as a whole will listen to voices beyond the NGOs remains a big question. Its form is not encouraging. Melvyn Whyte, an owner of Whyte Chemicals and vocal opponent of REACH, recalls one meeting in Brussels to discuss the proposal. Ms Wallstrom turned up, made a few remarks—and, says Mr Whyte, left without answering a single question.

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Vivendi

That's entertainment

Jul 17th 2003
From The Economist print edition

Vivendi's auction of its American assets has more twists than a soap opera

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AP

Diller rides again

THE clearest winner so far in Vivendi's auction of its American entertainment assets is Vivendi itself. Thanks to frequent leaks about the various media groups in the bidding, the troubled French conglomerate has created a masterful impression of fevered competition for its film studio, theme-park business and cable-TV channels. At a gathering of media moguls in Sun Valley, Idaho, last week, all the talk was of who will win. There are five known contenders: Metro-Goldwyn Mayer (MGM); Liberty Media; NBC; Viacom; and Edgar Bronfman, a former boss of Seagram. Vivendi, which is trying to reduce its debts, will unveil a buyer in September.

This week, MGM upped its bid to $11.5 billion, but told Vivendi that it would pull out of the auction unless it got more financial information by July 21st. Vivendi has reportedly refused both the raised offer and the demand for more detail. MGM's bankers are fed up with “teasing” by the French. Because Vivendi feels secure with so many suitors, bankers complain that there is little real progress towards a deal. Has Vivendi become complacent? “I am not convinced that the assets are compelling for a number of the other bidders,” says one investment banker involved. They are certainly not vital, he says, for Liberty Media, which this month spent $7.9 billion buying QVC, a shopping channel.

The bidders gain and lose favour every week. Liberty Media and MGM have both been strong favourites to win. MGM could make big cost savings by combining its film studio with Universal Pictures. Few people take Edgar Bronfman's bid very seriously—he may just be trying to push up the value of his own Vivendi shares. Vivendi has already kicked out one bidder, Marvin Davis, an oilman, because his bid was “dubious and unattractive”—in other words, too low.

With the financial backing of its owner, General Electric, NBC could easily trump the others. But nobody knows whether GE has the stomach for the volatile movie business, despite Universal's recent good box-office run of films (“8 Mile”, “Red Dragon”). Viacom only wants the cable-TV channels, which lowers its chances.

The wild card is not yet on the shortlist: Barry Diller. Mr Diller used to run the businesses Vivendi is selling; personally and through his firm, InteractiveCorp, he already controls a 6.9% stake in Vivendi Universal Entertainment. Mr Diller seemed ready to join forces with his friend John Malone, boss of Liberty Media, but now he is rumoured to be talking to Sumner Redstone of Viacom about a joint bid.

Private equity is playing a big role in the Vivendi auction. Providence Equity Partners, Morgan Stanley Capital Partners, the Blackstone Group, the Carlyle Group and the Texas Pacific Group are all, or have been, involved. This is partly because some big media firms are staying on the sidelines. AOL Time Warner and Disney are too stretched from past mergers to get involved in new ones. But movie businesses rarely come up for sale, and this unusual auction, bankers fervently hope, will provoke more deals from the moguls in the entertainment industry. Stand by for a lot more action.

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Coca-Cola under investigation

A bit of a fizz

Jul 17th 2003 | ATLANTA
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Coke faces an investigation, a cross ex-employee and an angry Burger King

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THE lawsuit filed by Matthew Whitley, a former internal auditor for Coca-Cola, against his old employers reads like a John Grisham novel. Mr Whitley alleges that Coke fiddled a marketing test for a new product, moved $4m into a slush fund to lower the price of expensive new machines, let those machines leech metal residue into dispensed drinks, improperly capitalised payments to bottlers, mis-stated net operating revenues—and then fired him when he reported it all to Steven Heyer, Coke's chief operating officer. At every turn, the lawsuit claims, Mr Whitley was thwarted by evil executives. He was one of 1,000 employees laid off in March, but in his case, says the suit, it was deliberate; Coke even created a shadow director to take over his responsibilities.

The company's first reaction was to shrug off the lawsuit, which was filed in May, as so much fiction. Mr Whitley is looking for some $44m, a large amount for an 11-year employee. Coke has established a reputation for being a well-governed firm: in the summer of 2002 it was one of the first companies to announce that it would begin voluntarily accounting for the cost of share options. But on July 11th Coke admitted that the district attorney's office for northern Georgia had begun an investigation into Mr Whitley's claims. The Securities and Exchange Commission is also reportedly conducting a separate inquiry of its own.

Coke's investigation found no basis to Mr Whitley's charges—save one. In 2000 a Coke executive, John Fisher, did indeed sign off on a plan to falsify the results of a marketing test in Richmond, Virginia, involving Frozen Cokes, a new product being rolled out at Burger King stores. Burger King, according to the lawsuit, spent $30m on equipment to produce Frozen Cokes, and wanted proof that children would actually buy the stuff. They did not. So, according to Mr Whitley, Mr Fisher paid a Richmond man $10,000 to round up hundreds of child buyers. Mr Fisher was reprimanded a year later, when the scheme came to light internally, but not fired; he did not leave Coke until April 2003.

Burger King, which had required its franchisees to sell Frozen Cokes, did not know about any of this until Coke revealed the results of its internal investigation last month. Mr Heyer then publicly apologised to Burger King's miffed chief executive, Brad Blum. On July 14th, Burger King announced plans to phase out Frozen Cokes, citing poor sales.

On the whole, Mr Whitley's charges are relatively minor, and analysts are not making too much fuss over the inquiry. Warren Buffett, who sits on Coke's audit commitee, vetoed Mr Fisher's firing on the ground that it would embarrass the company, according to Mr Whitley's lawsuit. But whatever the truth, Mr Buffett is unlikely to lose much of his lustre as one of America's savviest businessmen. Since the claims were made, Coke's share price has hovered around $44—a far cry from the high in 1998, but up from $37 in mid-March.

The American inquiries are not the only ones into Coke's business practices. Last month, the European Commission said it had not yet decided on its next move in an investigation of Coke for possible abuse of its dominant position in the market. In 1999, EU officials raided the offices of a number of Coke bottlers in Europe.

The bigger problem, in the long run, will be Coke's apparent alienation of Burger King. Despite recent poor sales, the company is still Coke's second-largest fast-food chain customer in North America, after McDonald's, accounting for 7-8% of Coke's sales there. Coke and Burger King are in the fifth year of a ten-year contract, but Pepsi (Burger King's supplier in the 1980s) has moved quickly against its arch-rival

in the past: when Coke was unable to buy Quaker Oats, with its popular sports-energy drink Gatorade, in 2000 (Mr Buffett disliked the deal), Pepsi snapped it up. Could Pepsi now try to lure away a disgruntled Burger King? “We'd like to win new business on our merits rather than Coke's mistakes,” says a Pepsi spokesman. Indeed. The battle between the world's biggest soft-drinks makers will ensure this affair continues to be a page-turner.

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Shareholder democracy

The hundred-year revolt

Jul 17th 2003 | NEW YORK
From The Economist print edition

America's elections of directors are being reformed, slowly

TO ARMS, shareholders! More than 60 years after the Securities and Exchange Commission (SEC) first contemplated democratising the election of company directors in America, the bureaucrats in Washington, DC, have mustered the courage to take a first, “bold” step on the path to reform. Yet boardroom fears of this “revolution” seem a tad overblown.

The vast majority of director elections in America are uncontested: board-nominated candidates run unopposed. Shareholders can withhold their vote, but, instead of needing a majority of shareholders, most firms need only one vote from one friendly shareholder to ensure a director's election.

Other than pleading with the board, the only way shareholders can hope to get alternative candidates elected is to mount a “proxy fight”. This entails publishing and mailing their own list of proposed directors to shareholders, escalating the contest, in effect, into a fight for control of the firm. This list of candidates competes with those on the firm's own proxy materials, sent to shareholders before annual meetings. Fighting for survival, incumbent boards and bosses often spend tens of millions of dollars of the firm's (or, rather, the shareholders') money to lobby for their candidates. Shareholders must finance their campaigns out of their own pockets. In all but the most egregious circumstances, they cannot justify the cost.

Prompted by the thought that shareholder participation might encourage a greater sense of responsibility among owners and accountability among directors, the SEC has proposed a limited form of enfranchisement. If implemented, shareholders would be able to put their own candidates on the firm's proxy materials, avoiding the expense and stark choices of a proxy fight. This right, however, is likely to be granted only in exceptional circumstances.

These might include when shareholders have registered their opposition to the firm's proxy by a sufficient number withholding their votes during normal director elections; or the successful passage of a shareholder resolution that the board subsequently ignores. The right to nominate is also likely to be restricted to shareholders that have had large stakes in the firm (say, 3-5%) for a long time (over a year)—thus disenfranchising the dreaded corporate raider. Further, shareholder-nominated candidates may be limited to, say, only two directors, meaning that it would take several years to use the mechanism to unseat entrenched boards.

Even these modest adjustments will face stiff opposition from America's business lobby. Businessmen have given dark warnings of the “confusion” that is likely to attend elections in which more than one candidate contests a board seat. They also say that directors may no longer put their names forward if there is a chance that they might lose. Just fancy that!

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European energy

Hungary's new empire builder

Jul 17th 2003
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A Hungarian powerhouse expands

MOL, a Hungarian oil and gas company, is leading a belated consolidation of central Europe's oil industry. On July 17th it was due to clinch a deal to buy 25% of INA, its Croatian state-owned counterpart, having outbid OMV, of Austria, with an offer of $505m. This will be MOL's second cross-border acquisition, having snapped up 36% of Slovnaft, Slovakia's sole refinery, in 2000, before acquiring majority control last November. Next in line for its attention will be Poland's valuable oil market.

A communist-era monopolist that went public in 1993, MOL revamped its management and operations in the late 1990s. As oil giants such as Royal Dutch/Shell cut into its share of domestic retail sales, now 43%, MOL fought back by becoming central Europe's leading oil firm. It chose to concentrate exploration and production in Siberia, through a joint venture with Yukos of Russia (see article).

Alas, its price-capped gas business has eaten into profits from refining, saddling MOL with huge debts and tarnishing its image among investors. A new regulatory regime should stem the losses, but the firm wants to sell the division. Although some analysts think MOL is overpaying for INA, since it will hold only a minority stake, Zoltan Aldott, the firm's head of strategy, says that, by creating a regional powerhouse with over 1,200 petrol stations across nine countries, the deal is a strategic coup. MOL has already reaped synergies in refining and marketing from its merger with Slovnaft, and a presence in Croatia will give it direct access to Russian crude-oil supplies from the Adriatic sea.

PKN Orlen, Poland's biggest oil firm, is due to announce its own strategy for regional consolidation soon. This week, its plan to merge with Poland's second-largest oil firm was blocked by the government. A link-up with MOL-Slovnaft, OMV and perhaps Unipetrol, a Czech oil group that is being privatised, might produce economies of scale and generate savings. But large state shareholdings in each firm, plus national pride, have hampered consolidation. “They've been talking about this for donkey's years,” laments Robert Rethy of Bank Austria Creditanstalt. Still, hope springs eternal, and Poland's treasury minister is keen on a central European oil alliance—so long as PKN is in the driving seat. Considering it is MOL that is already busily consolidating, that is a bit rich.

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Cordiant

Checkmate?

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WPP's takeover bid for Cordiant has become a game of intrigue

ADVERTISERS like well-crafted campaigns. The one put together by Sir Martin Sorrell, boss of Britain's WPP, the world's second-biggest ad agency, to take over Cordiant, a small and deeply troubled local rival, is due to reach a conclusion on July 23rd, when Cordiant's shareholders vote on the deal. But there is a problem with the endgame: it is caught up in a swirl of conspiracy theories over the real intentions of a big French rival, an aggressive London-based investment fund and a glamorous Syrian socialite.

To try to keep the deal on track, WPP succeeded on July 16th in having Cordiant de-listed from the London Stock Exchange, where it had begun life as part of Saatchi & Saatchi. This was in accordance with its offer to buy the firm for £10m ($15.9m), having already bought its debts of £256m. WPP, which sees Cordiant as a way to increase market share, hopes this will stop other investors building up stakes in Cordiant in an attempt to scuttle the sale.

One such investor is Nahed Ojjeh, a wealthy Syrian-born, Paris-based widow of an arms dealer, who (among other things) promotes chess tournaments. She has built up a holding of more than 10% in Cordiant, but she is not the only one moving strategic pieces around this particular board. Cordiant's biggest shareholder is Active Value, a fund that has made a name for itself by swooping on distressed companies. It owns almost 29%.

A number of motions are due to be put to the vote at the shareholder meeting. Among them is WPP's offer, which will require 75% support—which means it could be blocked by Active Value. But the fund's alternative plan to replace part of Cordiant's board with its own nominees, who would then demand a better price from WPP, suffered a blow when two of the executives it wanted to nominate pulled out. This development left Active Value exploring its options.

If the fund still tries to achieve what amounts to a change of control, it would require a simple majority of shareholders voting in support, which Mrs Ojjeh and others could help to provide. This in turn would trigger a clause in a put option that Cordiant has with the French advertising group, Publicis. Publicis, which was trumped by WPP in the bidding for Cordiant, is obliged under the terms of this option to pay £75m for Cordiant's 25% stake in ZenithOptimedia, a successful media-buying agency. Publicis already owns 75% of Zenith and would like the rest—but a change of control could trigger a revaluation, dropping the price to below £4m.

Maurice Lévy, the boss of Publicis, insisted this week that his company had no interest in acquiring Cordiant, directly or indirectly, and said he had declined proposals put to it by Active Value that would have resulted in a change of ownership. Yes, he admitted, he did know Mrs Ojjeh. But he denied that his firm had had any dealings with her over Cordiant.

Not surprisingly, Britain's takeover panel is watching the proceedings carefully. It has already had words with Mrs Ojjeh because her stake-building, at least initially, was done in secret. In particular, the panel is looking for any signs of shareholders acting in concert with one another, which in some circumstances is against Britain's takeover code.

Sir Martin will not be outmanoeuvred easily. While an attempt to wrest away control of Cordiant now looks unlikely to succeed, if it did get voted through he will put the company into administration—the equivalent of seeking protection under America's bankruptcy code. He can do that as owner of all the firm's debt, which also puts him in a strong position to negotiate the ultimate future of Cordiant with the administrators. But Mr Lévy could also try to negotiate with them—to reduce the price he must pay for Zenith. If this were one of Mrs Ojjeh's chess games, at least the loser could demand a rematch.

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Face value

The troubled face of Russian business

Jul 17th 2003
From The Economist print edition

What Mikhail Khodorkovsky's troubles say about business in Russia

AFP

UNTIL two weeks ago it seemed that there were no limits to what Mikhail Khodorkovsky could do. In a couple of years, a man with one of the worst reputations in Russian business had transformed both himself and his oil company, Yukos, into standard-bearers of modernity and transparency. He was fêted in western capitals, set an example that his fellow Russian magnates had grudgingly begun to follow, and became Russia's wealthiest man (and, according to *Forbes*, the 26th richest in the world). After announcing in April that Yukos would merge with Sibneft, creating an oil firm with reserves to rival those of the international majors, Mr Khodorkovsky seemed all-powerful.

Perhaps too powerful. The arrest two weeks ago of Platon Lebedev, one of Mr Khodorkovsky's closest associates, on suspicion of illegally acquiring a stake in a state-owned fertiliser firm in 1994, shook corporate Russia to its core. Nobody doubts that the arrest is political: in Russia, the order to nab a big fish invariably comes from on high. It was followed by investigations into tax returns filed by Yukos, and a delay to the antitrust commission's go-ahead for its merger with Sibneft. But why?

During the free-for-all infancy of Russian capitalism, Mr Khodorkovsky sailed as close to the wind as anybody. He managed to obtain credit vouchers that Soviet firms used in barter transactions, converted them into roubles, and then the roubles into hard currency. In 1989, aged 26, he started Bank Menatep, which helped organise the bidding for Yukos in 1995. In total, according to the firm, roughly $1.5 billion has been spent buying the assets that now make up Russia's biggest oil producer, with a market capitalisation—until Mr Lebedev's arrest—of $31 billion. His other skills included stock dilutions, loan defaults and holding shareholder meetings at short notice in inaccessible locations.

All that appeared to change in 2000, when Vladimir Putin, Russia's new president, struck a deal with the businessmen who had taken control of most of Russia's assets: their past misdeeds would be overlooked if they (a) kept their noses clean and (b) stayed out of politics. Two who tried to assert themselves, Vladimir Gusinsky and Boris Berezovsky, were forced into exile. Mr Khodorkovsky was the first to realise the further implications. Now the asset-grabbing was over, his firm needed to grow. Growth meant investment. Investment demanded stability and transparency, clear rules and minimal government meddling.

Yukos started to reveal its big shareholdings, publish accounts meeting international standards and pay taxes. Other firms noticed. Investment analysts began to distinguish between those who were or were not “doing a Yukos”. Sibneft had to clean up its books before the merger. Meanwhile, Mr Khodorkovsky began to preach the merits of free markets, checks and balances, and civil society. He did the rounds in the West, wooing journalists, investors and power-brokers. His friends and promoters include Henry Kissinger, Lord Rothschild and Lord Owen. He fancies himself as Russia's George Soros: his philanthropy includes providing internet-training centres for teachers, a forum where journalists discuss reform and democracy, and foundations that pay for archaeological digs, cultural exchanges and summer camps for children (where youngsters solemnly debate civic values, much as Mr Khodorkovsky no doubt debated socialist ideals as a leader of the Young Communist League). All this helped Yukos's share price.

The first signs that he was pushing the limits came earlier this year. He got into a public row over the government's insistence on keeping its oil-pipeline monopoly. There were smaller clashes over corruption

and Russia's stance on the war in Iraq. His open funding of two opposition political parties, and rumours that he was also giving money to the Communists—he said only associates of his did—made it look as if he was buying support in parliament. In May, the National Strategy Council, a think-tank, published a report hinting at an “oligarchic coup”. Then *Kompromat*, a muck-raking magazine, published a special issue on Mr Khodorkovsky. Mr Lebedev's arrest was the last straw. Since then, Yukos's share price has fallen by 14%.

War and peace

But what are the limits that Mr Khodorkovsky pushed against? Conspiracy theories abound: that there is a power struggle between two groups in the government, one linked to the oligarchs and one made up of Mr Putin's associates, each aiming to control his succession in 2008; that there is general displeasure—Mr Putin's included, or maybe not—with Mr Khodorkovsky's politicking, or maybe just with his economic power; that he is being made an example *pour encourager* other oligarchs, who may be doing political financing of their own; that people he outsmarted in the 1990s are out to get their own back; that his anti-corruption efforts have hurt some powerful officials; and so on.

What does all this say about the purported modernisation of Russian business life? The answer matters both to Russian businessmen and to foreign firms and investors, who have become more bullish on Russia than at any time since they were savaged after the country defaulted on its debts in 1998. Is Mr Khodorkovsky being punished for being the advocate of liberal values that he would like to paint himself as, or the aggressive capitalist he unarguably still is?

The most worrying hypothesis to some investors (though a happy one for many Russians) is that a general oligarch-hunt has begun. That seems unlikely; prosecutors are investigating Oleg Deripaska, an aluminium magnate, but that concerns a private dispute that began long ago. Yet, if nobody doubts that the business climate in Russia is better than it was, at least foreign investors should be on their guard again. The mood in Moscow, for now, is that the storm is likely to blow over. Mr Khodorkovsky has been taught a lesson, even if only he knows what it is.

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Information technology

The new geography of the IT industry

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As the information-technology industry's emphasis is shifting—from innovation to execution—so is its location

CONSIDER three snapshots of the IT industry today. First, look at the centre of the business at the turn of the century—Silicon Valley. Parts of this high-tech region to the south of San Francisco, which were buzzing with activity only three years ago, are coming to resemble an industrial wasteland populated by squirrels, racoons and “for lease” signs. In the city of Santa Clara, where almost half of all office space is vacant, rents run at around $1 per square foot, compared with $6.50 in late 2000. Some larger tenants in the city are even sub-letting space for nothing, just so they can share the service costs.

Then move north to Redmond, near Seattle, the home of Microsoft. The giant software firm appears to be defying gravity—because it controls two monopolies, Windows and Office, each generating some $10 billion in annual revenues, with operating margins of more than 80%. But the company seems to be running out of bright ideas about where to invest its money. Microsoft has almost $50 billion of cash in the bank. In January, it announced plans to pay a first-ever dividend of $870m this year, a figure that many now expect to be raised, with some talking of amounts as big as $10 billion.

For a third snapshot, turn to Electronics City, near Bangalore in India (above), home of the development centre of Wipro Technologies, an Indian IT services giant. Some 6,500 people work there, about half the firm's total staff, and new buildings are popping up all over the place. By 2005, the campus is scheduled to have three times as many employees as it does today.

Tech-tonic shifts

Welcome to the new geography of the IT industry, one that is no longer centred on Silicon Valley. It is the result of two distinct shifts that are reshaping the business. For some time, its centre of gravity has been moving away from the Valley to places such as Redmond, Austin, Armonk and Walldorf (in Germany), where four industry leaders—Microsoft, Dell, IBM and SAP, respectively—are based.

At the same time, large parts of the business are migrating offshore, mainly to India, but also to such places as China, Russia and Vietnam. This is already being likened to what happened to manufacturing in the 1970s and 1980s, when companies in the rich world moved many of their operations overseas. The IT industry is now developing something that it has not had before (except in hardware manufacturing): a fully operational, international supply chain.

Such geo-technological movements, in particular the one shaking Silicon Valley, are no surprise to economic historians. As technological phases in computing have come and gone, so have shifts in the industry's centre of gravity, argues Timothy Bresnahan, an economics professor at Stanford University. When the mainframe dominated the industry, he says, it clustered around New York; Boston then took over as the centre of minicomputing; while the PC, although born in Florida and Houston, came of age in the Valley.

It was followed by the internet, in many ways the perfect technology for the Valley. Entrepreneurship and venture capital were already in the blood there, and the web, with its open standards, allowed less tech-savvy entrepreneurs to create start-ups quickly and reach a wide audience. The region proved to be a Petri dish, or “innovation habitat”, offering plenty of the nutrients required to incubate and commercialise any new technology—including flexible networks of entrepreneurs, highly skilled employees, university researchers, venture capitalists, lawyers and business consultants.

Perhaps more importantly, the timing could not have been better. At the end of the 20th century, managers had two reasons to buy technology on impulse. First was the Y2K scare, which told them that their systems might be fuddled by the date change on January 1st 2000. Second was the fear of being “Amazoned” by an e-commerce start-up, such as the eponymous online retailer. It was Valley firms such as Sun Microsystems and Cisco Systems that were able to provide most of the equipment for carrying out e-commerce. Both benefited to the tune of annual growth rates of up to 40%.

The culture of the Valley thus became the dominant culture of IT everywhere. Buyers bet on Valley newcomers such as Siebel Systems and its “best-of-breed” customer relationship management (CRM) program, rather than waiting until established vendors of business software packages, such as Germany's SAP, caught up. IT managers were also persuaded to buy pricey high-end hardware that was crafted by the Valley's best engineers.

Sun also sets

Today, the IT industry is no longer dominated by start-ups, innovation and high-end equipment. Customers are more interested in consolidation, integration and execution than in the next big thing. And here the Valley's rivals have a competitive edge. SAP offers good-enough CRM programs as part of its suite of business software. Dell, boasting a super-efficient supply chain and increasingly powerful machines built with commodity parts, has become the downturn's hardware star.

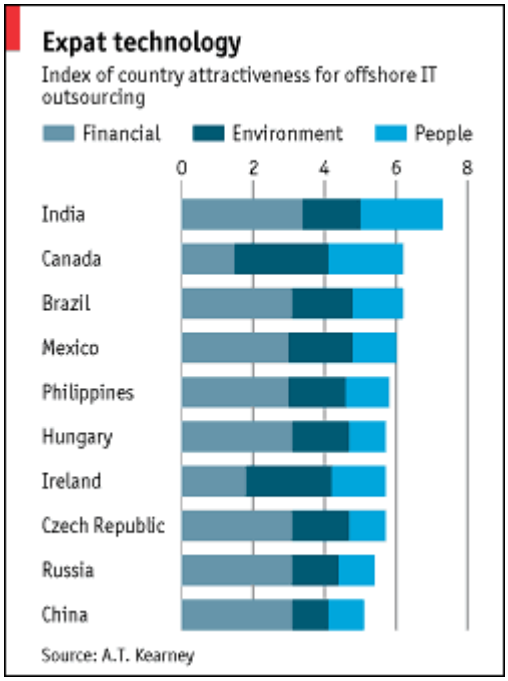
As a result, many of the Valley's leading firms are losing ground. Siebel and Sun, for instance, recently posted disappointing quarterly results. Dell, IBM and SAP, on the other hand, have been doing well, while Microsoft keeps beating expectations. Things would not perhaps be so bad for the Valley were it not simultaneously being undermined by a second shift in the industry. Most hardware is already built in places far away from its customers, but now other parts of the industry are also moving abroad.

This is the result of three separate trends that will increasingly become one, as the boundaries between software, IT services and business processes become blurred. First, software firms are setting up development shops offshore. Smaller ones have done this for some time: for example, firms such as Agile Software, a Silicon Valley company that sells programs managing all aspects of a product's lifecycle. More than half its 200 developers now work in India, Hong Kong and southern China.

More recently, the bigger firms have started to move offshore in a significant way. In June, SAP announced that it would double its workforce in India to 2,000 within three years. Last week Oracle, a Silicon Valley software firm that aspires to be bigger than Microsoft, announced that it is soon to double (to about 6,000) the workforce at its two Indian research centres, one of them in Bangalore. Microsoft too recently announced plans to expand its IT operations in India.

Then there are the home-grown Indian outsourcing companies, offering a wide range of IT services to western customers, from writing and maintaining programs to implementing enterprise

software and monitoring computer systems. The largest of these firms—Tata Consultancy Services (TCS), Infosys and Wipro—are starting to compete head-on with the large American outsourcers, firms such as Accenture, EDS and IBM Global Services. At the same time, the Americans are expanding their presence overseas. Accenture recently announced that it will triple its offshore workforce to 12,000 by the end of the year.



More significantly in the long run, a growing number of large companies are using IT to send entire business processes offshore, either by setting up overseas subsidiaries of their own or, to a lesser extent, by hiring local outsourcers. And this practice is no longer restricted to low-grade operations such as call-centres. General Electric, a pioneer in business process outsourcing (BPO), has increased its Indian workforce to more than 11,000. Among other back-office businesses, these employees analyse credit risks, underwrite loans and evaluate insurance claims.

Not surprisingly, the main reason for this shift offshore is cost control. With business slow and prices under pressure, firms are looking for ways to produce their wares more cheaply. Developing countries such as India offer plenty of opportunities to do just that. A programmer in, say, Bangalore costs an American firm about one-quarter of what it would pay for comparable skills at home. Add in the extra infrastructure and telecoms costs, and the savings are still in excess of 30%. Technology also plays a part. High-speed data connections and software tools have made it cheaper and easier for geographically dispersed teams to collaborate.

Firms that are selling software programs to assist such collaboration are themselves offshore pioneers. Agile is one example; there is also CollabNet, another Silicon Valley software firm. It offers a web-based service that allows teams of programmers to co-ordinate their work, and it has recently bought Enlite Networks, another collaboration start-up which develops many of its programs in India.

Equally important, says George Gilbert, a co-founder of TechStrategyGroup, a consultancy, is the fact that software development today is more fabrication than innovation. As much as 70-90% of what programmers do in a large enterprise software firm, for instance, is maintenance: upgrades, minor enhancements and bug fixes. Such programming tasks can more easily be done abroad. In addition, today's software is written in a more modular way, which means that parts of it can be coded separately.

Moreover, clients are increasingly at ease with getting important IT work done overseas—not least because they hired many Indian and Chinese engineers during the boom, and many have now gone home to work for one or other of the offshore firms. Indian IT services firms, in particular, boast first-rate development processes and have shown that they can handle large-scale projects.

Offshore limits

How much of the IT industry will move offshore, and how many IT jobs in America and Europe will disappear? In the United States there is already a political backlash, of sorts. Lawmakers are pushing to tighten visa regulations, so that foreign IT firms can no longer send their employees to customers for training. And several state legislatures have bills pending that would stop government agencies sending IT and other services work overseas.

Such reactions are misguided. For a start, although IT jobs are definitely moving abroad, this is no exodus. Even high-tech consultancies, which tend to exaggerate such trends, come up with numbers that, on close examination, are relatively small. Forrester Research predicts that more than 3m IT-related jobs in America will have moved overseas by 2015. That sounds a lot, but it is little more than 2% of total American employment today.

This trickle is unlikely to turn into a flood. Going abroad does not just bring rewards; it also carries risks. For a firm, picking the right partner can be tricky, and getting along can be even harder because of cultural differences and linguistic problems. Political stability is also an issue, as is the privacy of personal information and the protection of intellectual property.

But not sending work to places where it can be done more cheaply could well cost even more jobs in the long run. Using offshore workers helps companies to remain competitive and focus on what they are really good at. Having development centres in India and China allows them to maintain margins and so create new jobs (in the Valley or elsewhere), says Alfred Chuang, chief executive of BEA, another Silicon Valley software firm.

The limits to offshoring are already visible. To lower their costs, Indian IT services firms are themselves sending work offshore, to even cheaper places such as China. In 1999 a study by the National Association of Software and Services Companies (NASSCOM), a leading Indian IT industry group, estimated that the cost of employing top software engineers in India could be the same as in America in 15 years' time. Others predict that equalisation could happen much earlier.

Eventually, the IT services and software industries will globalise and probably operate much as hardware manufacturing does today, predicts Phil Codling, an analyst with Ovum Holway, a consultancy. The production of most computers and other electronic goods is today spread around the world in a way that makes most sense economically—taking into account labour costs, but also such factors as skills, cultural compatibility, proximity to markets and, not least, tax rates.

Something called “near-shoring” can often be an attractive proposition. According to A.T. Kearney, a consultancy, India leads the pack in offshore IT services mainly because of its low labour costs (see chart). But other countries such as Brazil, Canada and Mexico are not far behind and score more highly in other areas.

The division of labour within companies such as Agile and Enlite could become a model for both software and IT services firms. Things involving design and marketing will mainly stay onshore: developing a product's architecture, for example, or coming up with new features and keeping in touch with the market. Most of the actual coding, as well as customer support, however, will be done abroad.

How green is the Valley?

Who will dominate this new geography: the newcomers from India or their American rivals? The chances are, says Rahul Sood, another co-founder of the TechStrategyGroup and a former McKinsey consultant, that it will be easier for American firms to build a “back-end” offshore than for their Indian rivals to create a “front-end” onshore. In the long run, he says, offshoring will no longer be mostly about labour arbitrage. It will be about putting together an efficient global IT supply chain. And this is a skill that Indian firms have to develop if they want to compete at the top.

Yet American IT firms should not be lulled into thinking that there are areas where they are safe from overseas competition. Other countries will eventually have their own global IT heavyweights. A recent lawsuit over an alleged patent violaton between Cisco and Huawei, a Chinese telecoms-equipment maker, may be a sign of things to come. Although Huawei appears to have taken liberties with Cisco's intellectual property, the Chinese firm could grow into a dangerous low-cost competitor to the once dominant Silicon Valley company.

AP

Ready for the next wave of innovation

Is the Valley destined to become the Venice of the information age? Don't bet on it yet. The region has gone through similar cycles before—and adapted successfully. When PCs became commodities in the 1980s and were made more cheaply elsewhere, Valley firms, led by Sun, developed more sophisticated workstations.

These days, the Valley is again moving up the technology stack. Sun is trying to become more of a software firm, by developing software that automates the management of data centres, for example. Oracle wants to become the Microsoft of enterprise software, by offering a complete suite of business programs. And after its successful merger with Compaq, HP looks increasingly like IBM.

The trend towards ever cheaper and more powerful computer systems may also help the region. Google, for instance, is best known as a great online search-engine, but the Valley firm is just as notable for its inventive use of cheap hardware. Its super-efficient infrastructure of

thousands of servers allows it to keep introducing new services, most recently Google News, which automatically aggregates news on the web.

John Doerr, a Google board member and a partner at Kleiner, Perkins, Caufield & Byers, the region's foremost venture-capital firm, hopes that a successful Google share flotation will throw open the window for technology listings. It would certainly get things moving again in the Valley. There are other promising start-ups waiting to float, such as Salesforce.com, a firm offering web-based CRM services.

Yet the best hope for a comeback is for the Valley to ride what many expect to be the next big wave of innovation after the internet: the convergence of bio-, info- and nano-technologies. Each holds much promise in its own right, but together they could give rise to many new kinds of products. The Valley is well equipped to catch this wave, thanks to its “innovation habitat”, says Doug Henton, president of Collaborative Economics, a local think-tank. It is a habitat that is good at incubating not just IT start-ups. Already, the broader region (which includes Berkeley and other cities on the east side of San Francisco Bay) has the largest concentration of public biotechnology firms in America. According to Ernst & Young, there were 74 in 2001, compared with 48 around Boston and 31 around San Diego.

Yet such a habitat can also be a disadvantage, argues Donald Sull, a professor at Harvard Business School, in a recent paper analysing the rise and fall of the region around Akron, Ohio, where America's tyre industry was once concentrated. Initially, says Mr Sull, tightly knit social and professional networks allow knowledge to flow, which boosts innovation. But as an industry grows up, these networks also become a liability: increasingly set in their ways, they make a cluster less flexible and its firms more vulnerable to competition.

Valley folk insist that such collective inertia could never overcome them. Rather, they like to compare themselves with Yellowstone National Park two years after an immense forest fire. Yes, there are lots of scarred trees. But there are also many fresh green shoots springing from the ashes.

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Stockmarkets and economies

Irrational exuberance revisited

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AP

Recent rises in stockmarkets are not justified by the economic evidence

IN NEW YORK, London and most other financial centres, two opinionated groups have been holding forth of late. On one side are the miseries who pressed bond yields to lows not seen in decades: they shake their heads about the high prices of shares, colossal corporate and household debt, and global deflationary pressures. On the other are the cheerier people who take heart from companies' efforts to reduce their debts and costs, and from the determination of the Federal Reserve (though not, admittedly, the European Central Bank) to do anything necessary to get the economy going. This lot have been declaring the equity bear market over.

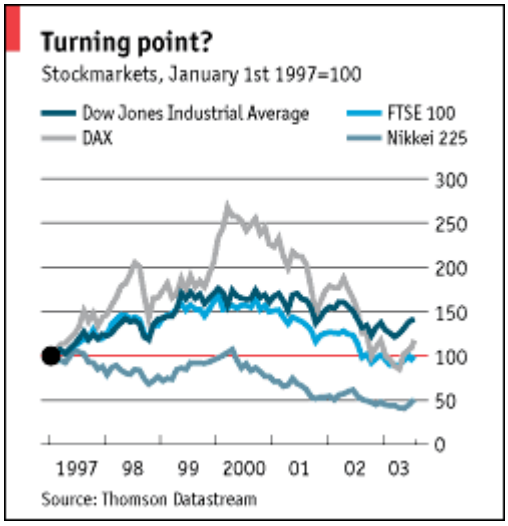
As bond yields have revived and share prices have risen in recent weeks, the second camp has been sounding the more confident. Their case was helped by an upbeat assessment of America's economic prospects by Alan Greenspan, the Fed's chairman, on July 15th—even though, funnily enough, stockmarkets slipped after he spoke. But they had been climbing for weeks before then.

In total, share prices have recovered only a little of the ground lost since early 2000 (see chart). Still, since its low point in March, just before the Iraq war, America's Dow Jones Industrial Average has risen by 21%; stockmarkets in Britain, France and Japan have jumped by 25-30%; and Germany's DAX has surged by 54%. In dollar terms 39 of the 40 markets that *The Economist* tracks in its indicator pages are higher than at the start of the year.

Until the middle of June, bond markets seemed to be sending an opposite message. Fearful of deflation, which raises the value of anything that pays a fixed rate of interest, investors bid bond prices up (and thus yields down). But in the past few weeks, yields on ten-year Japanese government bonds have more than doubled, to just over 1%. Ten-year American Treasury-bond yields have risen by almost a percentage point since mid-June, to close to 4%. Yields jumped by another quarter-point after Mr Greenspan's speech.

By his standards, Mr Greenspan was positively ebullient about America's prospects. Over the past three quarters GDP growth has averaged around 1.5% at an annual rate. But the Fed expects a strong rebound in the second half of this year, followed by growth of 3.75-4.75% in 2004.

Certainly, there is good reason to expect a spurt in growth over the next few months. America's monetary and fiscal policy has never been looser. But will such rapid growth be sustained? “If the past is any guide,” said Mr Greenspan, this “should bolster economic activity over coming quarters.” Yet the present business cycle is not a normal one. The past must be read carefully. History, not least in Japan, suggests that economies take longer to recover after bubbles: growth tends to remain subdued until the excesses of the bubble years, such as over-borrowing and over-investment, are purged.



Mr Greenspan gave the impression that these excesses have been much reduced, because firms and households have restructured and strengthened their balance sheets. This is optimistic. Although firms have cut costs, their debts have continued to rise. Households have not gone as far in repairing their balance sheets as Mr Greenspan suggests, largely because low interest rates have allowed consumers to keep spending. Many Americans have swapped their old mortgages for new, larger ones at cheaper rates. They have thus continued to build up debt, leaving themselves vulnerable to rising unemployment, or another stockmarket slide, or a fall in house prices.

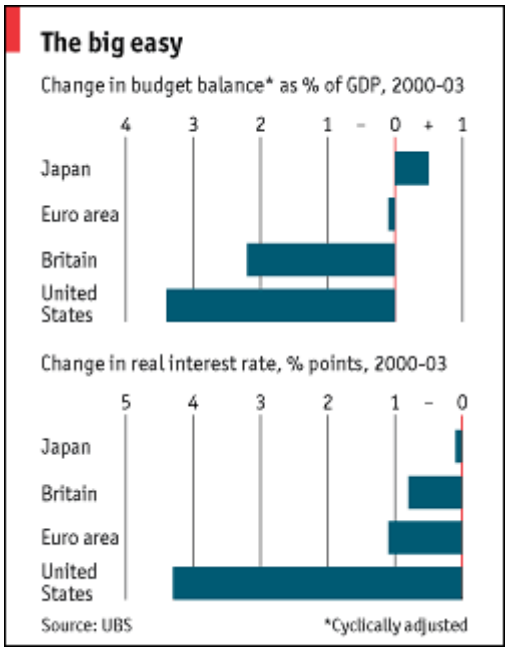
When long-term interest rates stop falling, mortgage refinancing will slow. If mortgage rates rise, refinancing could slump. This could cut consumer spending, pushing GDP growth back below trend. The importance of mortgage refinancing in supporting spending may explain why Mr Greenspan tried (but failed) to keep the bond market happy by signalling that short-term rates would remain low for as long as it takes to achieve strong growth and ward off deflation. If necessary, he said, rates could be cut below today's 1%.

Record breakers

Andrew Smithers, a London-based economist, says that America's extraordinary number of economic imbalances entitles it to an entry in the “Guinness Book of Records”: low personal saving, record levels of household and corporate debt, enormous current-account and budget deficits, and so on. So long as these persist, he thinks, monetary and fiscal reflation will provide only temporary relief.

Mr Greenspan argues that continued rapid productivity growth bodes well for future profits. Yet in a highly competitive market, in which firms have little pricing power, productivity gains are more likely to be passed on to consumers in lower prices. In any case, profits remain weak. Reported operating profits of American firms rose by a healthy 13% in the year to the first quarter; but, as measured (more accurately) in the national accounts, they increased by only 2% over the same period.

Small wonder. Profits depend on nominal GDP growth. Yet America's recovery is its weakest in modern times, and inflation is unusually low. As a result, nominal GDP has grown at an annual rate of less than 4% since output bottomed in the third quarter of 2001, compared with an average 9% rate in the two years after the previous eight recessions ended. Today's forecasts of double-digit profit growth in the next few years look unrealistic.



Recent rosiness about America is perhaps understandable, given how much money has been thrown at the economy. The chart puts the scale of America's monetary and fiscal easing into international context. Britain has also loosened fiscal policy significantly. In Japan fiscal policy has been tightened, while in the euro area, where until now budgets have been constrained by the stability and growth pact, it has been broadly neutral. Real interest rates have also been cut by far more in America (4.3 percentage points) than elsewhere. So it is no surprise that America's economy, though weaker than had been hoped, is expected to grow faster this year and next than either Japan's or the euro area's. Britain is also tipped for stronger growth of around 2.5% next year.

Yet there seems to be no relationship between the size of recent gains in share prices and recent revisions to growth forecasts. American shares have done less well in recent months than those in Japan and Europe (especially Germany). Expectations of growth and profits have held up better in Britain than in the euro area, yet the FTSE 100 has so far recovered by less than most euro-area indices.

The euro-area economies did not grow at all in the first quarter of this year, and may have shrunk in the second. The European Central Bank did not cut interest rates at its meeting on July 10th. Many economists think that growth and inflation will be lower than the ECB expects, implying sluggish growth in nominal GDP and therefore weak profits. Forecasts for GDP growth in Germany, the largest economy in the euro area, have been revised down (to zero this year and 1.2% in 2004, according to the forecasters polled monthly for our indicator pages), yet German share prices have risen roughly twice as fast as other markets since March. This may be because Germany's stockmarket had previously suffered a steeper fall.

In Japan, by contrast, the rally in share prices has been accompanied by much talk that the economy is at last on the mend. This week, the Bank of Japan upgraded its economic outlook for the first time in a year. But it is foreign buying that is driving up share prices. Perhaps locals know better. Although Japan's GDP grew by a robust 2.6% in the year to the first quarter, faster than America, and business confidence seems to be perking up, prices are still falling. So nominal GDP continues to shrink. In the year to the first quarter Japanese firms boosted profits by 12%, by slashing costs. Further big gains will be hard to come by so long as deflation persists, because job cuts will depress demand.

All in all, stockmarkets seem to have got ahead of themselves. Historically, bear markets do not end until shares become truly cheap. According to Mr Smithers, Wall Street needs to fall by a third to reach fair value—or by 60% to look as cheap as at the bottom of previous markets.

Share prices might, of course, rise a bit more in the short term. Funds have been sitting on cash that they must invest somehow, and nobody will want to miss out on a rally for fear of having that money taken away. But to take hold, rallies need support from both profits and cheap valuations. Ten years ago, at a similar remove from the bursting of its stockmarket bubble in 1989, Japanese share prices climbed by 30% in four months, spurred by falling interest rates and a large fiscal stimulus. They are a lot lower now. Smiling investors should take note.

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Economic language

The value of words

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Policymakers should choose them carefully

LIKE corporate accounts, economic statistics should be audited—not just to check whether a number is accurate, but whether the emotive words attached to it are correct. Thus trade surpluses are said to "deteriorate" (or trade deficits to "improve") when they shrink. This wrongly presumes that a surplus is always good and a deficit bad. In Japan a smaller trade surplus would be good news if imports were rising thanks to stronger domestic demand.

The latest example relates to inflation. Central bankers, brought up to believe that a rise in inflation is always bad, and a fall is good, are the main culprits. In his press conference on July 10th Wim Duisenberg, president of the European Central Bank, said no fewer than four times that the outlook for prices was favourable. He meant inflation was falling. But to critics of the ECB, who believe that the 2% ceiling for its inflation goal is too low, "favourable" might imply a rise in inflation. It certainly would in Japan.

More blatant still is the Maastricht treaty: countries wanting to join the euro must have inflation rates no more than 1.5 percentage points above the inflation rates in the three "best performing" member states. That is always taken to mean the lowest rates. But if deflation took hold, would that still be right? How about the three closest to the ECB's target—or even the highest?

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Citigroup

Sandy's surprise

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The world's biggest bank names one of Sandy Weill's acolytes as his successor

AP

Crown Prince

FOR years, a question has hung over Citigroup: who could run the world's largest financial institution when the man who built it, Sandy Weill, steps down? On July 16th Citi announced that Charles Prince will succeed Mr Weill, now 70, as chief executive on January 1st. Mr Weill will remain chairman for another two years. The question still stands.

Since last year Mr Prince, although a lawyer by trade, has run Citi's investment-banking operations. His appointment was widely seen as an effort to clean up the company's image after Wall Street's recent scandals, rather than an attempt to reorganise the bank's formidable trading and underwriting operations.

Mr Prince met Mr Weill in 1986 when the latter took over Commercial Credit, a high-interest consumer lender out of which, through one acquisition after another, the firm now called Citigroup was formed. Mr Prince was Commercial Credit's corporate counsel. Over the years, as one prominent executive after another departed, often after a row with Mr Weill, Mr Prince became his boss's *consigliere*. Loyal, he was never seen as a rival because he lacked a background in finance.

The market greeted Mr Prince's appointment by knocking 3% off Citi's shares. It might have been worse but for the thought that the succession may have been deferred, not decided. The planned changeover looks anything but straightforward. Citi will reorganise itself so that most main business lines will ultimately be run by Robert Willumstad, head of Citi's consumer operations. This could mean, in effect, that Mr Willumstad runs the company, says David Hendler, an analyst with Creditsights, an independent research firm. Mr Willumstad had been considered the most experienced internal candidate for the chief executive's job. His new position suggests he may not be out of the running even now.

There may be more twists ahead. As chairman, Mr Weill will be very much around. It is hard to imagine a man with such a taste for control stepping meekly aside. He has experimented with power-sharing several times before, notably after the merger in 1998 of his Travelers group with Citibank, run by John Reed. Every time Mr Weill has emerged with sole control. Given that this week's changes will not take effect for some time, it would not be a shock were Mr Weill to stay on, or find other candidates, either directly or after an acquisition.

Even so, in announcing his departure Mr Weill has rounded off a remarkable revival of both Citi's fortunes and his own. The bank's star telecoms analyst, Jack Grubman, was at the centre of Wall Street's conflict-of-interest scandal. Mr Weill himself was also tainted, although never a direct target of prosecutors.

Yet Citi has continued to generate extraordinary profits. On July 14th Citi announced second-quarter profits of $4.3 billion. Hence the stockmarket's abiding attachment to Mr Weill: the share price has almost doubled since last autumn's lows. The company's enduring profitability has driven down its funding costs. This has allowed it to buy lending businesses in the expectation of fat margins. An example is this week's $3 billion-plus purchase of the credit-card operations of Sears, Roebuck, one of America's largest retailers.

Can Citi keep this up? Although Mr Weill is derided as ruthless, autocratic and hypocritical—his own perks and compensation are lavish, yet he cracks down on anything similar among subordinates—he has been

remarkably skilled at making acquisitions that work, controlling operational risk and inspiring employees to follow where he leads. He also has the knack of pruning businesses that do not pay. All this is admired by regulators as well as investors: in Mr Weill, there is at least one person who understands his mammoth institution.

The bank Mr Weill leaves to Mr Prince—assuming he does leave it—has extraordinary strengths. Its sheer scale makes it an almost mandatory participant in the underwriting of every significant equity or bond issue. Although many talented employees have quit rather than work for Mr Weill, Citi retains some of the most capable people on Wall Street.

But there are troubles in store too. Although Wall Street settled with its regulators in April, private litigation over the tech-stock scandals has still to be dealt with. Many years will pass and many deals must be done before Mr Prince will prove a worthy successor to his mentor—a task all the harder because now that Citi has grown so large, there are few meaningful acquisition targets. Citi may have to rely on organic growth, but that too is difficult for such a vast institution. Hitherto, its corporate personality—that is to say, Mr Weill's—has been directed at buying. In all likelihood, the bank will not change until Mr Weill truly departs. And no one really knows when that will be.

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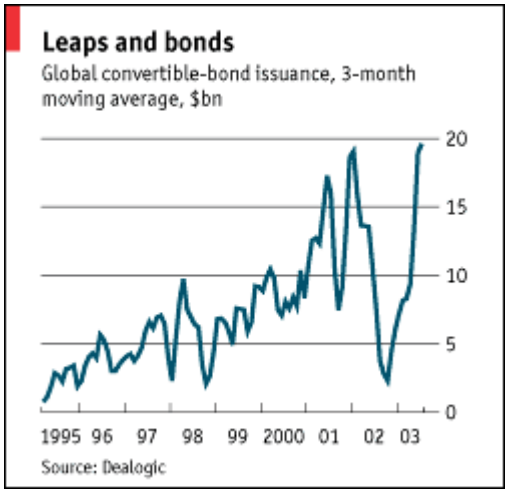
Convertible bonds

Options and opportunities

Jul 17th 2003
From The Economist print edition

Issuance of convertible bonds is soaring. Is demand flagging?



HOW wonderfully flexible financial markets are. Unable to repair their debt-laden balance sheets by issuing more shares, companies in both Europe and America have been flocking to the convertible-bond market. Issuance of these bonds in June was the second-highest monthly total ever.

Convertibles are a hybrid of debt and equity. Investors receive a lower rate of interest than on conventional debt, in return for the right to convert the bonds into shares if the share price rises above a certain point. So companies end up either paying less interest (good) or issuing cheapish equity (better). Investors get some income, plus the chance of equity that rises in value.

That, at least, is the sales pitch. As it happens, most buyers in Europe and almost all in America have been hedge funds. Most have little or no interest in using convertibles as a low-risk way of getting into the stockmarket. On the contrary, as short-sellers—investors who sell stock that they do not own—many would be delighted if the share prices of the companies in which they invested dropped to nothing.

A convertible is, in effect, two financial instruments in one: a bond, plus a call option on the company's shares. Investors pay for the call option by forgoing some interest on the debt. However, companies issuing convertible debt have been selling the option too cheaply. The main determinant of the value of an option is the volatility of the underlying asset over the life of the option. In the case of convertibles, the more volatile the price of shares, the more the option is worth. And companies assumed that their shares would be less volatile than they actually were.

Hedge funds have latched on to the opportunity for arbitrage this has thrown up. A hedge fund buys the convertible and sells the debt component, keeping the call option. It then sells the company's shares short, giving it a hedge against movements in the share price. As the share price moves up and down, the fund adjusts its short position, a tactic known as delta hedging. The hedge fund makes money if the shares turn out more volatile than was assumed by the issuer of the convertible.

In the past couple of years hedge funds specialising in such techniques have been among their industry's best performers. Lately, though, the strategy has become less profitable. For one thing, volatility has fallen by half: the VIX, the Chicago Board Options Exchange's volatility index on the S&P 100, has dropped from 40 in January to 22 now. For another, investment banks have been more aggressive in pitching for convertible business, and convertibles have become more expensive.

Moreover, the sharp reduction in the tax American companies pay on dividends has led to a marked increase in the number of companies raising payouts to shareholders. This is painful for anybody shorting the shares, because they have to pay those dividends.

For all these reasons demand has fallen, and the investment banks that launched them have lots left on their books. Issuance will probably fall. This may be no bad thing. Companies have been issuing convertibles to make it look as though they were cleaning up their balance sheets. They could have issued debt and sold call options on their shares, which would have been economically if not psychologically equivalent. But all they have ended up doing is selling something—options—too cheaply. Hedge funds have been the beneficiaries.

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Baseball

Tiger economy

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An unlikely source of salvation for Japan

PERHAPS Japan's economic policymakers have run out of ideas. Lately they have been heard cheering on the Hanshin Tigers, a baseball team located near the western city of Osaka, in the hope that their extraordinary recent run might revitalise the lacklustre economy.

The Tigers were last national baseball champions in 1985, since when they have been perennial no-hopers. Yet this year they have staged one of the most remarkable resurgences in Japanese sporting history. When Osaka staged the annual All-Star game, which marks the mid-point of the season, on July 15th, the Tigers were already so far ahead of the rest that the championship looked all but secure.

This is helping to take Osakans' minds off the state of the local economy, which is terrible even by Japanese standards. Corporate bankruptcies in the city rose by 47% between 1999 and 2002, compared with 26% nationwide, according to Teikoku Databank, a research firm. Osaka's unemployment rate is well above the national average; and a higher proportion of its office buildings stand empty. In May, Resona, a big local bank, was forced to apply for ¥2 trillion ($16.7 billion) of public funds, after it found itself short of capital.

It now seems that the Tigers' success is giving the local economy a tonic. In festive mood, people are drinking, eating and going out more. They are snapping up goods stamped with the Tigers logo, from soft drinks to wine to cars. Amagasaki Shinkin Bank, a local bank, collected ¥228 billion in one-year deposit accounts for which the interest rate will be multiplied by 7.7 if the Tigers top the league (the Tigers' manager wears number 77).

The Japan Research Institute estimates that victory for the Tigers will pump ¥113 billion into the Osaka economy. Some think the national economy will benefit as well, because the Tigers have a wide following outside their home turf. Academics at Osaka Prefecture University suggest that the Japanese economy would be boosted by ¥88 billion and more than 9,000 jobs be created. Even more optimistically, Jiro Ushio, a member of Japan's Council of Economic and Fiscal Policy, which advises the prime minister, believes the economy could gain by ¥1 trillion.

Hard to credit? Eager for any hint of a strengthening economy, other top officials have seized on the Tigers' success—especially when they happen to support the team. One fan, Heizo Takenaka, the economic and financial minister, hopes that a victory will “change (Japan's) economic landscape”. At the Bank of Japan, another supporter, Toshihiko Fukui, better known as the governor, says that, in Japan, “economic recoveries spread from the west.”

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Canadian finance

Not to be trusted

Jul 17th 2003 | TORONTO
From The Economist print edition

Another investment that's too good to be true

CONFIDENT that they have found the answer to unpredictable stockmarkets and miserly bond yields, Canadian investors are pouring money into tax-sheltered income trusts. Over 40 new trusts have been listed on the Toronto stockmarket in the past two years, bringing the total to 116, with a combined market capitalisation of C$52.6 billion ($38 billion), 5% of the value of all listed shares. A handful, such as Fording, North America's biggest metallurgical-coal exporter, are also listed in New York.

The trusts raise capital by selling units to investors. The money is then invested in the equity and debt of an underlying operating company. The company reduces its tax liability by paying most, and sometimes all, of its pre-tax operating income to unit-holders. In theory at least, the unit-holders can then rely on a steady income.

Before the recent boom, income trusts were mainly confined to oil-and-gas producers and property developers, which usually reinvest only a small part of their cashflow in existing businesses. Returns, including distributions and capital gains, have typically been between 8% and 15%, mouth-watering by today's standards.

With investors hungry for yield, a remarkable collection of companies have been reinventing themselves as trusts. In the past 18 months these have included North America's biggest peat-moss producer, a cheque printer, a meat processor, an icemaker, a coffee decaffeinater and, this month, a compiler of telephone directories. Not shy of hype, some issuers have promoted themselves as “income-plus-growth” investments, promising investors the best of both worlds.

Some wonder whether it is sensible for many businesses to keep paying out such a high proportion of their cashflow. The concern is that pressure to keep up payments may discourage not only bold investments or acquisitions, but also maintenance of existing assets. Fans of the trusts counter that high payouts instil discipline, discourage reckless expansion or diversification, and force managers to make a case to outside investors if they spot a worthwhile opportunity.

In any event, some trusts are paying out less than many investors had assumed. Last month the Legacy Hotels income trust, which owns some of Canada's best-known hotels, suspended payments after a slump in bookings, caused mostly by the outbreak of severe acute respiratory syndrome, or SARS, in Toronto. In recent months Legacy had been paying out more than its operating profit. So, among others, had Sun Gro Horticulture Income Fund, the peat-moss supplier, which has cut its payment by 14%.

Worse still for investors, cuts in payouts are invariably followed by falls in unit prices. Gordon Tait, who covers income trusts for BMO Nesbitt Burns, an investment bank, gave warning in a recent report that the prices of many trust units, even in the relatively safe oil-and-gas industry, are likely to drop.

A year or two ago, Canadian analysts and financial advisers were trumpeting income trusts as a safe and reliable investment. Now, they are reminding investors that the trusts are, in essence, high-yield—and thus high-risk—equities.

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Indian mutual funds

Privates' progress

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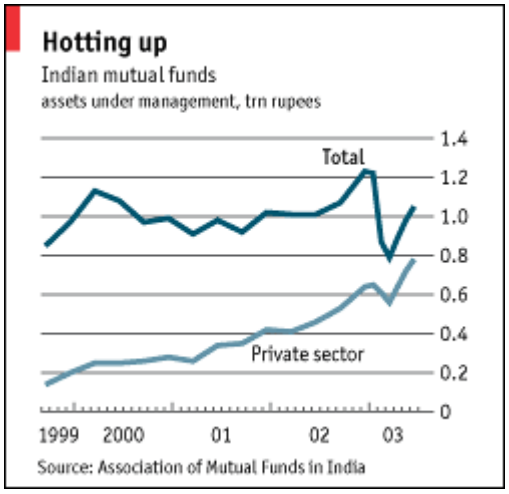
In a state-dominated market, private fund managers are making inroads



THE Indian mutual-fund industry looks far healthier than it did only a few months ago. In February state-controlled Unit Trust of India (UTI), for almost 40 years India's biggest asset-management company, was restructured, on a smaller scale, having almost collapsed twice and been bailed out three times in five years . Meanwhile, private funds have been consolidating and gaining ground. They now manage three-quarters of the 1 trillion rupees ($22 billion) that Indians have entrusted to the industry, up from 47% a year ago. In a country where the government remains the chief manager of money, running the biggest banks, insurance companies and pension funds, this is a remarkable change.

Granted, the rise in the private sector has been exaggerated by UTI's restructuring: sick funds containing some 298 billion rupees were put into a special undertaking and have been dropped from industry statistics. Even so, the value of assets managed by private firms has climbed by 69% since June 2002 (see chart).

The new UTI remains market leader, even if, with 160 billion rupees under management, it is only one-third of its old size. However, consolidation among private firms has put three of these—Prudential ICICI, a joint venture between a British insurer and an Indian bank; America's Templeton; and HDFC, the local partner of Standard Life, a British mutual—in the same league as UTI, each managing assets of just under 120 billion rupees.

Last year Templeton bought Pioneer ITI, an American-Indian joint venture. Last month HDFC acquired the local asset-management arm of Zurich Financial Services. This month Principal, an American financial-services firm, said it would acquire funds managed by Sun Foreign & Colonial, a British-led joint venture. Fidelity, America's biggest fund manager, is thought likely to set up shop in India soon; several foreign banks have already done so. In large part, firms are readying themselves for the deregulation of the Indian pension market announced in February by the finance minister, Jaswant Singh.

Despite the private companies' recent success, there is still plenty of room for growth. Investments in mutual funds are less than one-tenth of bank deposits. Only one-third of the funds are from retail investors, mostly in five big cities. Compared with banks, which have 65,000 branches between them, fund managers have weak distribution systems. Principal is hoping to sell its funds through a tie-up with India's vast network of post offices. Deutsche Bank, which quit retail banking in India a couple of years ago, launched its mutual funds recently, once it was sure that it could pay others to carry out distribution, settlement and custody.

So far, the industry has focused on bond or cash funds, which account for 80% of assets. Largely this is because most investors are risk-averse, and want something like a bank deposit, with safe principal and a regular income. However, the higher charges on equity funds (typically 1%, against 0.5% on bonds) also play a part. Some asset managers are keen to push equity funds, worrying that bond funds, easy to sell when interest rates are falling, might now lose their allure. Through their recent purchases, Templeton and HDFC have acquired the country's top equity funds. Others are sticking to what they know best, remembering how equity funds were hammered in the tech-stock bust: Standard Chartered, for instance, manages only bond funds in India.

Mr Singh's shake-up of the pension market ought to give India's private fund-management companies a fillip. Yet only a lucky few might benefit. A government panel, headed by a former chairman of UTI, has proposed that six private pension-fund licences should be auctioned: those bidding the lowest management fees would win. Most of the 30-odd private firms would be eligible to bid.

The result would be cut-throat competition and shoddy products, says Milind Barve, managing director of HDFC Asset Management. He may be right: a free-for-all, in which the mix of fees and products were set by the market, might be better. The price of mistakes will be high. The bail-outs of UTI, which also ran pension funds, cost taxpayers 160 billion rupees.

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Economics focus

Of manias, panics and crashes

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The work of Charles Kindleberger, who died on July 7th, has never been more pertinent

"A LOT more economists than you might think can write well," says Peter Dougherty, Princeton University Press's economics editor, who is compiling an anthology to be called "The Elegant Economist". A slim volume, you might imagine, but Mr Dougherty reels off a long list of those who have put aside equations and supplied a well-turned phrase to explain the dismal science. Adam Smith wrote memorably sometimes, but he is a harder read than John Maynard Keynes or Milton Friedman, let alone John Kenneth Galbraith, so stylish a writer that he was once asked to join the English faculty at Berkeley. Mr Dougherty ranks Paul Krugman and John Kay, who each have a newspaper column, as the best today. He believes there is more talent among economics writers now than ever, perhaps fittingly as a result of fiercer competition. But, says Mr Dougherty, the "model for economists who want to reach a wider audience" was surely Charles Kindleberger, who died on July 7th, aged 92.

A self-confessed "literary economist", Mr Kindleberger, a professor at MIT and the author of more than 30 books, was a critic of the growing reliance of the economics profession on mathematics and on what he regarded as over-narrow rational models of human behaviour. Only a few years ago, his work would have been praised more for its readability than its insights. But he lived to see his best-known book become essential reading on Wall Street and be cited approvingly by younger, more mathematically inclined academics.

In "Manias, Panics and Crashes", Mr Kindleberger provided a comprehensive history of financial crises, stretching back to before the South Sea bubble. He argued, not wholly originally, that several common threads linked these different disasters over the centuries in almost all corners of the financial world. Manias, or bubbles, have typically occurred in the markets following unexpected good news, and so reflect progress of sorts. "New opportunities for profit are seized, and overdone." When this eventually dawns on investors, the financial system may experience distress and often panic.

His book first appeared in 1978, when most economists who studied finance were in thrall to efficient-markets theory, which in its purest form rules out the possibility of bubbles. In so far as it acknowledged past bubbles, the theory blamed them on immature, fraud-prone markets and argued that they were unlikely to occur in sophisticated, well-regulated, modern settings.

The recent dotcom bubble, following such other apparent inefficient-markets events as the 1987 stockmarket crash and the Asian meltdown of 1997-98, changed that, although pure efficient-markets theory was by then already under fierce attack. Mr Kindleberger's work suddenly seemed spot on. Now, studying bubbles is all the rage in academia. There are several schools of thought. "Behavioural" economists, for instance, see recent bubbles as evidence that markets are "irrational", reflecting psychological biases such as over-optimism among investors.

Perhaps more interesting has been the reaction of those most loth to abandon rational *Homo economicus*. Only a few old believers cling to the idea that the rise in dotcom share prices genuinely reflected likely profits, and that their sudden plunge was caused by regulatory (in)activity. Most prefer to ask why informed, rational investors failed to arbitrage away the absurdly high prices caused by irrational buying, as efficient-markets theory predicts. In a 1997 paper, "The Limits of Arbitrage", Andrei Shleifer and Rob Vishny noted that the cost of shorting—selling borrowed securities in the hope of a fall in price—tends to increase, the further above true value that prices rise. This may discourage arbitrage that would bring the market back to its senses.

In a similar spirit, Matthew Richardson of New York University argues that a limited float of dotcom

shares prevented short-sellers from borrowing shares to sell. When the supply of shares rose, the bubble popped. Others argue that investors who saw that the market had gone daft may quite rationally have driven prices up further, believing they could get out faster at the peak than the greater fools who would buy shares from them. Not everybody is convinced by such theories. Peter Garber, who has disputed whether some famous crazes, such as the Dutch tulipmania in the 1630s, were really bubbles at all, says there may now be a bubble in bubble theories: “Academics increasingly say there is a bubble as a substitute for thinking hard about the fundamentals of security valuation.”

In the last resort

Mr Kindleberger believed that “markets work well on the whole”, but occasionally “will be overwhelmed and need help” from a lender of last resort. He understood both the danger of inaction by such a lender and the “moral hazard” that its mere existence can create, by encouraging investors to be reckless in the belief that they will be bailed out if all goes wrong. Thus, he argued, a “lender of last resort should exist, but its presence should be doubted.” It should always come to the rescue, but “always leave it uncertain whether the rescue will arrive in time or at all, so as to instil caution.” Pulling this off is, he noted, a “neat trick”.

Economists are split over the recent performance of America's lender of last resort, the Federal Reserve. Some argue that its policy of easy credit inflated the bubble, although nobody can be certain what effect tighter money would have had once the bubble began to expand. Some economists believe that the Fed's interest-rate cuts since the bubble burst have been a triumph, preventing a severe recession. Others think that the Fed has merely postponed the day of reckoning. We will never know what conclusion Mr Kindleberger would have reached. What is certain is that he would have expressed it with clarity and wit.

The fourth edition of "Manias, Panics and Crashes", (Wiley), by Charles Kindleberger, was published in 2000. (Amazon.co.uk)

"The Limits of Arbitrage", by Andrei Shleifer and Rob Vishny, appears in the *Journal of Finance*, March 1997.

The best introduction to the behavioural finance approach to bubbles remains "Irrational Exuberance", (Princeton University Press), by Robert Shiller, first published at the peak of the bubble in March 2000. (Amazon.co.uk)

Peter Dougherty displays his own flair for writing about economics in "Who's Afraid of Adam Smith?", (Wiley), published in 2002. (Amazon.co.uk)

"Famous First Bubbles: The Fundamentals of Early Manias", (MIT Press), by Peter Garber, includes an analysis of tulipmania.

Interesting recent papers on bubbles include:

"DotCom Mania: The Rise and Fall of Internet Stock Prices", by Matthew Richardson and Eli Ofek, NBER working paper, December 2001;

"Bubbles and Crashes", by Dilip Abreu and Markus Brunnermeier, *Econometrica*, 2003;

"Overconfidence and Speculative Bubbles", by Jose Scheinkman and Wei Xiong, *Journal of Political Economy*, 2003.

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AIDS

Trick or treatment?

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Getty

Two decades after the identification of HIV, the world has realised that poor people as well as rich ones should be treated for their illness

Get article background

PATENTS last for 20 years. On July 9th a famous one expired: the first antibody-based test for the human immunodeficiency virus. Yes, HIV has been around that long. And it is still getting worse. More than 40m people are now infected. At least 20m have died.

That is the background against which two meetings have just been held in Paris. The first, on HIV pathogenesis and treatment, organised by the International AIDS Society (IAS), was a scientific gathering. The second was about money, to discuss the Global Fund that was formed to fight AIDS, tuberculosis and malaria. But in dealing with AIDS, science and money are inextricably linked.

So, increasingly, are containment and treatment. And that is a big change. When HIV was first identified, no treatment was possible. When it became so, it was too expensive for most people. Health planners in poor countries therefore concentrated on prevention rather than cure. The reasons given for this were that cures were not cost-effective and that the poor could not be trusted to take their drugs properly, which would encourage the evolution of drug-resistant strains of the virus. What they forgot was that somebody who has no prospect of treatment has little incentive to be tested, and so identified as a potential link in the chain of transmission.

Both arguments have now been knocked down. If anything, African patients seem more sophisticated than their rich-country counterparts. Papa Salif Sow, of Dakar University in Senegal, told the IAS conference that the consensus of studies in Africa over the past few years was that 80-85% of people took their drugs exactly as prescribed. In the rich world, the figure is more like 60%.

Pay up, pay up and play the game

The sneering assumption, then, that ignorant Africans will be less compliant with complex drug regimes than sophisticated westerners is false. One of the perils of non-compliance is the development of drug-resistant strains of HIV. This is already a problem in the rich world. A big new study, unveiled at the meeting, showed that about 10% of all newly infected patients in Europe now suffer from drug-resistant

strains of the virus.

As for the economics of treatment, they have changed beyond recognition. Generic knock-offs of AIDS drugs, plus some hard bargaining by governments, can bring the price down to less than $200 for a year's supply, says Jean-Paul Moatti, an economist at the University of the Mediterranean in Marseilles. As Dr Moatti told the conference, health authorities in rich countries consider a treatment to be economically desirable if it costs less than twice the GDP per head in that country. On this measure, treatment is now economically justifiable in a lot of poor countries. And new models that account for the loss of output from workers who will now never be born suggest that AIDS's economic impact will be worse than expected.

Unlike other sorts of scientific conference, AIDS conferences attract angry activists as well as sober scientists. This year's favourite slogan was “Treat the six million. Where's the ten billion?” Six million is the number of people who have severe enough symptoms to benefit from the anti-AIDS drug formulations known as HAART (highly active anti-retroviral therapy), the most expensive and effective sort. And $10 billion is the amount of cash that, it is said, could usefully be spent each year on treating and preventing AIDS.

In an act of generosity that temporarily silenced America's critics, George Bush announced in February that he wanted his country to provide almost a third of that, by spending $15 billion ($10 billion of which would be new money) on AIDS over the next five years. The critics soon found their voice again when it became clear that much of this would be bilateral aid, rather than aid channelled through the Global Fund. But when the haggling stops, it looks as though the fund could see at least $500m of American taxpayers' money heading its way next year.

A lot of that money, though, will be in the form of matching funds that are conditional on others stumping up two dollars for every American one. France has promised *euro*150m ($168m) a year. Germany and Italy have each promised *euro*100m a year but don't say when the cash will start to flow. And there was no money from the European Union (as opposed to individual member states), despite the hopes raised at the recent G8 meeting in Evian.

As for corporate donors, few companies are in a position these days to sign big cheques for charity. But, as the fund has found, largesse comes in many forms. For example, it has just signed a deal with a big, and as yet undisclosed, European bank whose clients, many of them in the developing world, will be able to use their credit cards to make donations. The fund is also having its profile raised by Publicis, an advertising firm that has taken on the fund as a *pro bono* client.

Even if the Global Fund does not get all it wants—eg, an annual budget of $7 billion—the money will not be wasted. Tommy Thompson, America's health and human services secretary and also chairman of the Global Fund's board, says the bilateral part of Mr Bush's package is aimed at 14 African and Caribbean countries, which contain half the world's infected people. Following the new treatment paradigm, half the cash will be spent on HAART for 2m-3m people.

Anthony Fauci, the head of the National Institute of Allergy and Infectious Diseases in America, and one of Mr Bush's chief advisers on AIDS, also tried to allay some of the fears of activists by making it clear that the money would not have to be spent on the costly products of American drug companies. It can be used to buy generics instead.

As Ernest Darkoh of Botswana's health ministry pointed out, though, throwing money at the problem and then walking away is not enough. The money must be spent wisely on gathering information, building a suitable infrastructure, and training and paying medical staff. This needs political will to act—an often overlooked factor. But perhaps most important, the stigma of being infected has to be eliminated, and this takes time.

The devil and the detail

In Botswana, some 300,000 adults are infected. Of these, 110,000 could benefit from HAART. What makes Botswana different from other countries is that HAART is already available to anybody who wants it, thanks to a collaboration between the government, the Gates Foundation and Merck, a drug company. But only 9,000 people have requested it, because of the shame they suffer if they admit that they are infected.

This, though, is a vast improvement on the 500 who were registered 12 months ago. And other African countries are also recruiting. Uganda has 10,000 people on HAART, Cameroon has 6,000 and even impoverished Mali has 700 recruits. Here, the lesson of Brazil is instructive. This country acted quickly to preach the anti-AIDS message, break the disease's stigma and wrestle cheap drugs from the pharmaceutical companies. Today only 0.6% of the adult population is infected.

When the money arrives—whether from the Americans, the fund, the World Bank, multinational companies (several of which now provide anti-AIDS drugs for employees) or from the resources of the infected countries themselves—the numbers in treatment should rise rapidly.

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Missile defence

Shooting down the moon

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Boost-phase missile-defence will not work

IT HAS been described as hitting a bullet with a bullet. These are America's plans for a missile-based defence programme to intercept and destroy incoming ballistic missiles before they can reach American soil. It sounds like a nice idea. The problem is that a group of eminent physicists and engineers—all long-time members of the defence establishment—have declared that a crucial part of it would be next to useless if it were built.

The plan for missile defence is to create systems that can intercept an incoming ballistic missile during all three stages of its flight—the “boost phase”, while the missile's rocket engine is still firing, the “midcourse”, when the missile coasts through space, and the “terminal phase”, after the missile re-enters the atmosphere. Stopping a missile in its boost phase is an attractive idea because the missile is unable easily to deploy decoys or to fragment into many sub-munitions. But this phase is short, lasting a mere three or four minutes—and therefore hard to hit.

The new report, published by the American Physical Society (APS) on July 15th, assesses whether a boost-phase defence system could work within the government's planned time-frame of 10-15 years. The Missile Defence Agency (MDA), part of the Department of Defence, is working on two kinds of defensive weapon for this purpose: anti-ballistic missiles (ABMs), which run into a ballistic missile at high speed, and lasers, which heat up the missile until it fragments.

According to an analysis of the basic science and technology of boost-phase systems, the performance needed to intercept a solid-fuel missile (a type likely to be used) would require unrealistically large and powerful interceptor missiles. Space-based interceptors would have a slight advantage over land- and sea-based interceptors, because they are not constrained by the need to be geographically close to the missile launch site.

Yet to get enough coverage would mean putting over a thousand interceptors into orbit. These would cost $40 billion merely to launch, and involve a wildly unrealistic five- to ten-fold increase in America's launch capacity. The APS report also notes that the work of such interceptors could be made harder by deliberate last-minute variations in speed and trajectory by the target missile, radar jamming, or multiple missile launches—none of which would be hard for potential adversaries.

As for airborne lasers, although they take only a fraction of a second to reach their targets and are thus less affected by a missile's avoidance manoeuvres, they suffer from other problems. They have only a limited charge (they work by combining vats of chemicals), focus on only one target at a time and can easily be fooled by using simple countermeasures—such as spinning the missile, lining it with cork or launching on a cloudy day. As the airborne laser would have to be flown quite close to its missile targets (it is carried by a large aeroplane), it would be vulnerable to attack by surface-to-air missiles.

The MDA has so far only responded by saying it is confident it is heading in the right direction and the technology has great potential. But in drawing its conclusions, the study group made the generous assumption that the system would work perfectly—optimistic given the recent history of test failures in ABM test programmes. The systems necessary to link arrays of space-based sensors and land-, sea-, air- and space-based weapons with sufficient accuracy during the short boost phase are complicated and unproven. A further worry for the boost-phase system is that military commanders have at most 30 seconds to debate whether to shoot down a missile that might actually be a peaceful satellite launcher. Given the scientific reservations about a project that has cost so much already, it is not surprising that the General Accounting Office (Congress's non-partisan investigative agency) has criticised the MDA for not using enough “knowledge-based practices”.

Some of America's friends and allies, however, may be hoping such incompetence continues. This is because of a final interesting twist in the tale. In the unlikely event that either ABMs or lasers could be made to hit a missile during its boost phase, they would not destroy the hardened warhead. A successful intercept of a missile launched from either North Korea or Iran thus runs the risk of dropping the missile's warhead, and its cargo of nuclear, biological or chemical weapons, on to Canada, Russia, or western Europe. One man's meat might turn out to be another man's poison.

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About sponsorship

Depression

The long and the short of it

Jul 17th 2003
From The Economist print edition

Depression can be caused by a particular gene and a stressful environment

THE often contentious debate about whether it is one's genes or one's environment that is the more potent shaper of one's human essence was, until recently, unclouded by many facts. But last year, a rather striking fact was provided by Terrie Moffitt and Avshalom Caspi, of the Institute of Psychiatry at King's College London, and their colleagues.

The two researchers found that violence in adults could result from the interaction between an abusive childhood and two different versions of a DNA switch that controls a gene called monoamine oxidase. Both childhood abuse and a particular version of the switch are needed to give a high chance of a person's becoming violent. In other words, then, it is nature with nurture that is the key, and not nature versus nurture.

Now Dr Moffitt and Dr Caspi are back, in a paper in this week's *Science*, with a similar conclusion for those who are trying to understand the causes of depression. The story starts with a gene called 5-HTT that controls the uptake of a chemical called serotonin into nerve cells. Serotonin carries signals between nerve cells and helps to regulate a person's mood. Persistently low levels of it are thought to cause depression. Several antidepressants, including Prozac, are thought to work by blocking the uptake of serotonin into nerve cells. If it hangs around longer, it produces a stronger signal.

However, people can inherit different versions of a region of DNA—known as a promoter region—that is responsible for switching 5-HTT on and off. Dr Moffitt looked at the versions in 800 young men and women involved in a New Zealand project called the Dunedin Multidisciplinary Health and Development Study. The subjects have been studied from birth, and are now in their late 20s.

5-HTT-promoters come in two flavours, known as “short” and “long”. Since people inherit one version of this promoter from their mother and one from their father, they can have two shorts, two longs, or one of each. The researchers divided their subjects into each of the three groups, and also according to those subjects' experience of stress and depression. They wanted to see what effect stress in a person's early 20s had, and considered stressful events related to such things as relationships, employment and health.

Of those subjects who were seriously stressed in their early 20s (having four or more stressful episodes, after a stress-free youth), 33% who had a copy of the short version became depressed. By contrast, only 17% of those with two long versions succumbed to the black dog. Almost a quarter of reported cases of depression could be accounted for by the 10% of subjects that had both short versions of the promoter and stressful experiences.

Severe stress alone will not cause depression; the sufferer must have the short promoter variant. And the two-thirds of the population that have this must suffer severe stress before they are likely to become depressed. Having one without the other is no different from having neither.

There is only one fly in the researcher's ointment. Short versions work by creating less of a protein that sucks serotonin away from the junctions between nerve cells. This suggests that people with short versions of the promoter have serotonin that hangs around for longer. But if scientists are also right about the way that Prozac-like antidepressants work, then it would be expected that people with short versions would be less susceptible to depression, not more. Add to this conundrum the fact that antidepressant drugs take weeks to have an effect, even though measurable serotonin levels rise soon after they are taken. It seems likely that the mechanism is far more complicated than was previously thought.

More research, as scientists delight to say, is needed. But the broad message is clear enough. The more science learns about the genome, the more vulnerable to experience genes appear to be.

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About sponsorship

South African history

The bonds that bound

Jul 17th 2003
From The Economist print edition

iAfrika

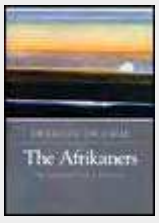
A new history explores the roots of the Afrikaners' fascination with apartheid

HOW could a high-minded community, proud of its values and devoted to its independence, have ended up embracing one of the most perverse ideologies of the 20th century? That question lies at the root of a magisterial new study, “The Afrikaners: Biography of a People”, by Hermann Giliomee, a distinguished South African historian and commentator.

Infuriated at their treatment by the British and frightened by the burgeoning African population, Afrikaners fell victim, he argues, to a maniacal preoccupation with their own cultural survival. In this interpretation, the momentous episodes in South African history—the Great Trek, the Boer war, the National Party victory of 1948 and even the transfer of political power in 1994—can all be understood as calculated steps by Afrikaner leaders to preserve and defend the *volk*.

Mr Giliomee's thesis has been received with a certain coolness by some historians who have been less than convinced by his attempt to walk the delicate line of explaining the slide into apartheid without condoning it. But the strength of the book lies in his distillation of a lifetime's research and reflection into a single prodigious volume.

The Afrikaners: Biography of a People
By Hermann Giliomee



C. Hurst & Co; 750 pages; £18.95. To be published in America by the University of Virginia Press in September

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The early chapters are filled with examples intended to correct the shallow portrayal of Afrikaners as cartoon racists. Mr Giliomee carefully details the accumulating grievances and the chafing bitterness endured by each successive generation, and suggests that many Afrikaner practices, foul in hindsight, did not deviate far from their historical mean.

Afrikaner commandos did indeed decimate the Khoikhoi peoples in the eastern Cape, but so did British imperial soldiers. Afrikaners in the Transvaal denied Africans the right to vote, but so did liberals in the Cape. Afrikaners instituted strict racial registries and social segregation but so did the citizens of the United States. Mr Giliomee similarly tries to snuff out the accusation that apartheid sprang from the crude genetic bigotry of the Nazis, arguing convincingly that the notion of separate development emerged from the well-intended missionary ideology of the Dutch Reformed churches in South Africa.

With its tight focus and its occasionally lurching chronology, this is not a book for newcomers to South African history. For those who have some background in the area, Mr Giliomee's view that it is historically inaccurate, morally unfair and politically dangerous to reduce the story of the Afrikaner literally to black and white will be persuasive, however. The tale of how a community gradually sweet-talked itself into sophisticated brutality is far more interesting and disturbing, and it will remind readers of how easily the assumed virtue of human ends can blind us to the viciousness of our means.

Mr Giliomee's determined efforts to show that Afrikaners, while perhaps misguided and delusional, were not mean-spirited, occasionally blow him over the delicate line between historical explanation and moral justification. He soft-pedals the remorseless cruelty of many of the South African government's acts—forced removals, widespread torture, deep corruption and the routine assassination of political enemies. He describes, but does not descry, the frightening sleight of hand by which the South African prime ministers who took office after 1948, particularly the pathological Hendrik Verwoerd, defended apartheid as the embodiment of the Afrikaner's honourable desire to grant Africans equal rights at some elusively distant moment in the future.

Towards the end of the book, Mr Giliomee comments revealingly that “apartheid failed because it was imposed.” This hints at the enduring unspoken question behind the political history of whites in South Africa. If other nations, such as India and Pakistan, could choose partition as the solution to their political and cultural problems, why could it not have been embraced in South Africa?

There are blunt physical answers to this question, ranging from the disparate size of the racial populations to the wide distribution of white control over the country's natural resources. The most important, however, is intellectual; the idea of a homogenous *volk* is fundamentally and deliberately anti-historical, a mental rubric built and exploited for political purposes. Mr Giliomee knows this as well as anyone; he was one of the earliest scholars to debunk the foundation myths propagated by the National Party.

Yet his loyalty to the idea of Afrikaner distinctiveness, revealed in his conviction that one can write a “biography” of a “people,” is both evident and contradictory. Who are the English, but the descendants of 20 centuries of European tribes who crossed the English Channel and dug themselves in? Who are the Americans? A sandstorm of ethnicities, blown in from around the world and scattered across a continent. And who are the Afrikaners? They are, as Mr Giliomee himself judges, a cultural and racial potpourri of white Africans who invented their own language, practices and history as an antidote to their fear of absorption and evolution.

Mr Giliomee struggles valiantly to offer a fair verdict on his own community. His ambivalence—instructive in the way it helps us consider how to avoid the alluring dark paths down which many nations have been lost—is not a weakness but the book's abiding strength, for it allows Mr Giliomee fully to explore the complexity of his subject.

The Afrikaners: Biography of a People.
By Hermann Giliomee.
To be published in America by the University of Virginia Press in September
C. Hurst & Co; 750 pages; £18.95.

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About sponsorship

Britain and the Hashemites

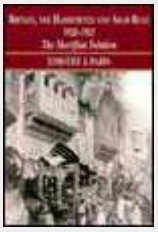
For king and country

Jul 17th 2003
From The Economist print edition

IT WAS once a whole lot easier. Eighty-five years ago, after the first world war, the great powers of the time split up most of the Middle Eastern provinces of the defeated Ottoman empire, turning them into mandates under British or French rule. Britain, which got the lion's share, plonked down a couple of Arab kings to reign over its territories in Mesopotamia and Transjordan, without bothering about trivialities like the wishes of the indigenous people. Local notables, with their affiliations and alliances, were ruled out. Better, it was thought, to appoint outsiders who knew nothing of their new kingdoms.

Winston Churchill, briefly but influentially colonial secretary, did suggest that it might be a good thing if the new king appeared to be chosen locally. Good, perhaps, but impractical. How, in Mesopotamia, for instance, to get agreement on this, or anything else, from northern Kurds, southern merchants and various tribes, none of whom particularly wanted to be part of an Arab state called Iraq?

Britain, the Hashemites and Arab Rule, 1920-1925: The Sherifian Solution
By Timothy J. Paris



Frank Cass; 392 pages; £39.50

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The snag in those days, as Timothy Paris expounds, was not protest in the "liberated" lands, but the internecine quarrels of the British government. The Foreign Office, the Colonial Office and the all-powerful India Office (scared lest British meddling in Arab Muslim affairs inflame Indian Muslim agitation against the Raj) were at each other's throats. Direct rule of the territories was dismissed, partly because Britain, in the heat of battle, had rashly promised Arabs some form of independence, but also because of post-war finances. As Churchill laid down: "Everything that happens in the Middle East is secondary to the reduction in expenses."

Churchill, who admitted that he had a virgin mind on the Middle East, relied on his creative, spin-doctoring adviser, T.E. Lawrence. Together, they promoted "the sherifian solution", under which the Hashemite family—Hussein, the sherif of Mecca, and his sons—would rule over the region under Britain's eye.

The family, though pre-eminent in the Arab world, had its imperfections. The British thought Faisal, with his good war record, a fine upright fellow, but despised his brother Abdullah as an indolent aesthete too fond of practical jokes, and couldn't abide the father, described by Reader Bullard, a not-unprejudiced British diplomat, as a "cunning, lying, credulous, suspicious, obstinate, vain, conceited, greedy, cruel Arab sheikh".

At first, Faisal was to be king of Syria. Unfortunately, the allies allotted Syria to France, and Faisal was brusquely ejected. As second best, the British packed him off to Mesopotamia in 1921. Eleven years later, as Iraq, it became the first mandated territory to obtain independence. This left Abdullah, who had had his eye on Mesopotamia, looking for a throne. He was given the job, temporary at first, of king of Transjordan, a land considered unimportant, except in its relation to Palestine. His lazy character, it was correctly assumed, might make him tolerant of the Zionism that was burgeoning next door.

Not so Hussein himself, who remained unamenable to British pressure. Treaty talks came to nothing, and the British withdrew their protection, opening the way for Ibn Saud, the king of the Nejd, to conquer Hussein's kingdom of Hijaz in 1924, and launch Wahhabi rule over Saudi Arabia.

Mr Paris's lengthy descriptions of British governmental squabbling are probably for aficionados alone. But he has an illuminating tale for today's neo-imperialists in Iraq. Britain does not emerge well: it sought to protect its interests with minimum cost and without thought to local aspirations. Yet, probably by luck

rather than judgment, its sherifian solution proved remarkably durable. Hashemite rule survived in Iraq until 1958, and, in Jordan, continues strongly to this day.

Britain, the Hashemites and Arab Rule, 1920-1925: The Sherifian Solution.
By Timothy J. Paris.
Frank Cass; 392 pages; £39.50

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The Serene Republic

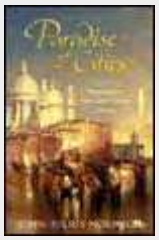
Venice for pleasure

Jul 17th 2003
From The Economist print edition

THE travellers who visit Venice in this delightful volume sought inspiration of the kind only Venice can give. So it seems odd that Lord Norwich should start with Napoleon, who hated the city, Whenever he arrived, he could not wait to leave. Presumably he is included because his destruction of the Serene Republic in 1797 was the reason why Venice was left with only its beauty and its memories, and why it hardly changed during the next 100 years. That became its charm.

In the case of Lord Byron, Venice inspired his libido so vividly that he emerges as a strong rival to the local champion, Casanova. He did admire “the gloomy gaiety of their gondoliers and the silence of their canals” but what he seems to have liked best of all was the flattering promiscuity of Venetian women: “Some are countesses and some are cobblers' wives, some noble, some middling, some low and all whores.” His exertions during the carnival inspired him to write “So we'll go no more a-roving/So late into the night.” But Byron did not stop a-roving until Venice finally exhausted him, and he could declare it was “like an oyster without a pearl”.

Paradise of Cities: Venice and its Nineteenth-Century Visitors
By John Julius Norwich



Viking; 283 pages; £20. To be published in America by Doubleday in October

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John Ruskin, who called Venice “a paradise of cities”, was a different kettle of *vongole*. His libido was so far down the Byronic scale that he was pronounced incurably impotent in his divorce from his wife Effie. (“As everyone knows,” writes Lord Norwich at his most schoolmasterly, “[John Everett] Millais and Effie fell passionately in love.”) Ruskin loved the Venetian Gothic, and although he deplored later architectural excesses, he drew them and described them so well that he inspired generations of the sort of English diplomats and scholars who eventually set up Venice in Peril, a conservation fund that Lord Norwich chaired for 30 years.

Wagner found the city's stillness indispensable to him while he was writing “Tristan und Isolde”, though the only music he liked listening to was the Austrian army band, especially when it played excerpts from his own compositions. Lord Norwich suspects Wagner of exaggeration, but accepts that Titian's “Assumption of the Virgin” in the Frari might have helped inspire “Die Meistersinger von Nürnburg”. Henry James, who knew Venice for 40 years, “might be said to have completed his cultural education in Venice”.

Reuters

Not all Venice's distinguished visitors were inspired by her. Edward Gibbon and Mark Twain felt an immediate instinctive revulsion. Dickens, like Napoleon, was irredeemably prejudiced against the city. Robert Browning allowed Venice to grow on him. But for Lord Norwich it was love at first sight. He has communicated this so well that we will surely miss him now that he has, as he says, decided to lay down his pen on the subject of Venice. Or maybe, like Dame Nellie Melba, this will be only the first of his final appearances.

Paradise of Cities: Venice and its Nineteenth-Century Visitors.
By John Julius Norwich.
To be published in America by Doubleday in October
Viking; 283 pages; £20.

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Business in China

Brand land

Jul 17th 2003
From The Economist print edition

FROM personal computers to refrigerators to underwear, China has become the world's workshop. Look around and almost everyone owns something with a “Made in China” label. But who outside China can name a single Chinese brand?

Very few, yet. Middle Kingdom companies are wrestling with the transition from cheap, mass manufacturer to producer of higher-value goods to satisfy an increasingly sophisticated domestic market. Suddenly Chinese managers are having to think about differentiation, niches and branding.

Seeking to cast light on this change are the authors of “Brand Warriors China”: Serge Dumont, a Frenchman who founded the first public relations agency in China, has lived there for the last 18 years and Fiona Gilmore, a British branding consultant, who spent six months on the road with him visiting Chinese companies.

Fourteen of them, plus a city, Shanghai, are profiled in the book—largely in the words of their own executives, from well-known groups like China Mobile, with more cellular phone subscribers than Vodafone, to relatively obscure domestic players such as Tong Ren Tang, a 333-year-old herbal medicine business. Even regimented China throws up its share of colourful characters. Kan Yue-Sai, the female founder of an eponymous cosmetics firm and a former broadcast journalist, started with $150 in her pocket and is now recognised by 95% of the population as the woman who introduced lipstick to China. She has even launched a doll of herself. And Zhang Yue, the boss of Broad, a maker of “green” air conditioners, has built an imitation Palace of Versailles among his factories because of his passion for 18th-century French philosophy.

Bag a brand

The book was written in a hurry and it shows in a number of sloppy mistakes. Britain's Bass, for example, is described as a German brewer. Nevertheless, it conveys a strong sense of how inventive and excited China's new entrepreneurs are. It it is a fair bet that some of the companies in this book will one day make it very big.

Brand Warriors China: Creating Sustainable Brand Capital.
By Fiona Gilmore and Serge Dumont.
Profile Books; 234 pages; £14.99

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About sponsorship

New fiction in Spanish

A heavenly voice

Jul 17th 2003
From The Economist print edition

IT IS now almost three decades since Mario Vargas Llosa shook off youthful communism and evolved into a passionate liberal democrat. But as a writer, extremism still fascinates him. In his last novel, “The Feast of the Goat”, he returned triumphantly to the theme of Latin American dictatorship. Now, in an ambitiously intricate historical novel that has shot to the top of the sales lists in the Spanish-speaking world, he has turned to another recurring interest: the quest for utopia.

“El Paraíso en la otra esquina” (Paradise in the other corner) tells, in counterpoint, the stories of Flora Tristán, an early French feminist and Utopian socialist, and that of her grandson, the painter Paul Gauguin. It lacks the tense drama of his last effort. But, as one has come to expect from Mr Vargas Llosa, the book is meticulously researched and cleverly crafted. Some readers may wonder whether this is really fiction. It is. The author's imagination is hard at work.

The implicit thesis is that the two protagonists are linked by more than just kinship. Both gave up the possibility of bourgeois comfort in pursuit of an ideal, of radical social reform in one case and of art in the other. And both found inspiration far from France, in less formal and less developed societies.

El Paraíso en la otra esquina
By Mario Vargas Llosa

Alfaguara; 485 pages; euro21.95. To be published in America by Farrar, Straus and Giroux and in Britain by Faber and Faber as "The Way to Paradise" in November

Buy it at
Amazon.com
Amazon.co.uk

Of the two, Tristán's story will be less well-known to the average reader. It is also the more tragic and the less entertainingly told. Her life was marked by the double injustice of illegitimacy and a disastrous marriage to a brutish engraver. It was her determination to free herself from those travails that made her a radical—and led her in the 1830s to make a voyage to Peru, the homeland both of Mr Vargas Llosa and of the wealthy family of Tristán's dead father, a Spanish colonel.

Out of Tristán's experiences there came “Peregrinations of a Pariah”, a minor classic of early travel literature, in which the grumpy French reformer cast an observant eye on a chaotic, unfair yet spirited country. It made her a celebrity in the salons of Paris, a status she traded for that of Madame-la-Colère, an agitator who flogged her failing body round France, denouncing the oppression of women and appalling social conditions, and seeking recruits for her Workers' Union.

Gauguin's idealism was of a different kind. After five years as a seaman, he became a successful stockbroker and married a bourgeois Dane who bore him five children. At the age of 35, he discovered his vocation as an artist. A restless search for inspiration led Gauguin first to Tahiti and then to the remote Marquesas Islands, whose primitive societies were imbued with a spiritual belligerence that he believed was absent from jaded western art.

These parallel life stories are marked by telling contrasts. One concerns sex. Tristán is a puritan, whose only sexual happiness came from a lesbian relationship she broke off, telling herself, “the only sentiment your life had room for was love of humanity.” Gauguin turned from dutiful husband into a randy old goat; today, he might be condemned as a paedophile. While Flora denounces marriage as the forced sale of woman to man, Gauguin buys himself a teenage concubine.

The author has argued that the search for Utopia is integral to artistic creation but disastrous when pursued as a political project. Gauguin triumphed as a painter—but only posthumously, and at the cost of self-destruction. As the title suggests, it is man's lot to believe that the grass is greener elsewhere, and in different ways, both of the protagonists fail in their quest for earthly paradise. In the past, Mr Vargas

Llosa might have laboured these points. Now, a great writer at the top of his craft, he lets his characters speak for themselves.

El Paraíso en la otra esquina.
By Mario Vargas Llosa.
Alfaguara; 485 pages; euro21.95. To be published in America by Farrar, Straus and Giroux and in Britain by Faber and Faber as "The Way to Paradise" in November

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About sponsorship

Performance theatre

Angel delight

Jul 17th 2003 | NEW YORK
From The Economist print edition

A show that makes you see the familiar with new eyes

NINETY dollars is a lot to pay for a city walking tour. But theatre enthusiasts are flocking to Deborah Warner's performance piece, “The Angel Project”.

With its nod to Wim Wenders's 1987 film, “Wings of Desire”, in which angels look out from Berlin's high-rise buildings and occasionally swoop down to help people in distress, Ms Warner's theatrical walk is a ticket into some of New York's hidden treasures. It begins on Roosevelt Island, in a field that offers a magical view of Manhattan which few people—even New Yorkers—will have seen. From there, it is a short subway ride to the first site, an abandoned and miserable walk-up apartment with a broken electric heater. Next is a 27th-floor loft space carpeted with white feathers which are lit by naked bulbs. A cage holds two tiny birds, and there are also two rows of metal lockers each marked with the name of an angel. Propped up in a corner is a worn postcard depicting the baptism of Christ.

Instead of the to-be-expected pornography in a 42nd-Street peeporama, large boxes of bibles and korans invite the visitor to contemplate the temptations of religion. In the balcony of the disused, yet still beautiful, Liberty Theatre, a winged angel appears. An elderly bearded man stares, saint-like, into the middle distance while on the floor lies the body of a man. Dead or asleep, one does not know.

Mozart booms from speakers at the last destination—the 63rd floor of the magnificent Chrysler building—while a black angel sleeps sweetly on the floor. In one room a table is covered with stacks of bibles, korans and Milton's “Paradise Lost”. A middle-aged man sits by an open window, and stares out. A young man crouches by another open window, suggesting a possible suicide or maybe an angelic flight. The vista from the top of the building is overwhelming—at once beautiful and terrifying. The feeling in these rooms, filled with the exalted voices of a choir and the presence of the young men, suggests the questioning, tormented world of a Dostoevsky hero. Most shocking are the open windows. An open window high up in a skyscraper is most uncommon—perhaps even illegal. But it is for each member of the audience to decide if it is open to let the angels in or out.

“The Angel Project” continues until July 27th. Tickets are available through www.lincolncenter.org

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About sponsorship

Broadway

Hard day's night

Jul 17th 2003 | NEW YORK
From The Economist print edition

Vanessa Redgrave, America's new love

AMONG the surprises of the current New York theatre, none is more startling than the emergence of Vanessa Redgrave in “Long Day's Journey Into Night” as a bona fide Broadway star. Ms Redgrave has already won an Oscar and an Emmy, so why shouldn't she have a Tony—Broadway's highest honour—of her own, a feat she and her co-star, Brian Dennehy, accomplished at the ceremonies last month?

Now 66, Ms Redgrave has been an all too infrequent visitor to Broadway, the same community where her eldest daughter, Natasha Richardson, landed her own Tony, in 1998, for the revival of “Cabaret”.

Ms Redgrave first played Broadway in 1976 (in Ibsen's “The Lady From the Sea”) and then in 1989 (in Tennessee Williams's “Orpheus Descending”). During that time, Redgrave the political firebrand tended to overshadow Redgrave the classical actress, especially in a theatre capital like New York that was thought to be disapproving of her overtly pro-Palestinian sympathies. (Her 1977 Oscar acceptance speech, with its much-vaunted reference to “Zionist hoodlums”, didn't impress America.)

So it is that only now has she lent her name to the sort of stage event on which New York theatre thrives. As the morphine-addicted Mary Tyrone, Ms Redgrave is the wounded and wounding epicentre of a four-hour-plus familial epic that is doing hefty business, with box office grosses regularly in excess of $600,000 a week. Older than many Mary Tyrones, Ms Redgrave, as might be expected, isn't afraid to suffer for her art. Rarely has this play's aggrieved matriarch looked quite so cadaverous, as if Redgrave's Mary has peered long and deep into the abyss of a play famously described as having been written in “blood and tears”.

Her fearlessness is matched by Philip Seymour Hoffman's portayal of Jamie Jr, which suggests that the young Tyrone family tearaway is every bit his mother's son in his mercurial and dangerous shifts of mood.

The result? It is not every day that Eugene O'Neill, even at his grandest, outgrosses “Chicago”, “42nd Street” and the season's surprise flop, Baz Luhrmann's “La Bohème”. For restoring the seriousness to a sometimes frivolous thoroughfare, Ms Redgrave deserves a long, deep bow.

“Long Day's Journey Into Night” is at the Plymouth Theatre, New York, until August 31st

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Hartley Shawcross

Jul 17th 2003
From The Economist print edition

Topham

Hartley William Shawcross, prosecutor at Nuremberg, died on July 10th, aged 101

PERHAPS Hartley Shawcross will be remembered by a single sentence: “There comes a point when a man must refuse to answer to his leader if he is also to answer to his own conscience.” He was presenting the case at Nuremberg in 1945 against Germans accused of making aggressive war and of crimes against humanity. Their leader, Adolf Hitler, had killed himself. Twenty-two of Hitler's civilian and military chiefs were now on trial, a proceeding that was to end with 12 of them being sentenced to death.

The effectiveness of the Shawcross opening speech, spread over two days, is that he was able to challenge the notion that the trial was an act of vengeance by the victors. He showed that the laws the defendants had broken had been expressed in international treaties and agreements before the second world war. Germany, before Hitler came to power, had been a party to many of them. Under Hitler, he said, Germany had been organised for aggressive war, and its crimes against peace had been the parent of other crimes. On the question of conscience, in his closing speech he asked how any of the defendants could have remained ignorant of thousands of Germans exterminated because they were old or mentally ill, or of millions of other people of various nationalities “annihilated in the gas chambers or by shooting”. Each defendant, he said, was a party to “common murder in its most ruthless forms”.

American, French and Russian lawyers all made speeches during the 216-day trial. But in their book, “The Nuremberg Trial”, John and Ann Tusa say the two Shawcross speeches stood out. Unlike Robert Jackson, who aimed to keep the bulk of the case in American hands and spoke first, he did not favour crusading oratory. “Shawcross's style, his manner of delivery and above all his intellectual approach were entirely different...his method was to concentrate on expounding the law which he believed already existed.”

Sir Hartley Shawcross (the title went with the job of attorney-general) returned to Britain from Nuremberg much praised in the newspapers and Parliament for his needle-sharp mind and (incidentally) for outpointing the uppity Americans. Where would he go next?

Looking the part

Sir Hartley found himself named as a likely future prime minister, a prediction bestowed on many politicians that is usually the kiss of death. But he did look the part. Not only was he clever, he was a

good-looker, always an asset for a leader. He said he was to the right of the ruling Labour Party, but no one much minded that. Clement Attlee, the prime minister, was a reformist but no leftie. Nor was Ernest Bevin, the foreign secretary.

His parents had been liberal middle-class, his father a professor of English and his mother a suffragette. Young Hartley honed his voice at street-corner political meetings. Geneva University gave him polish. He gained first place in English law exams and built up a law practice in the north of the country. His mastery of a brief and his fearsome talent for cross-examination made him a rising star. In 1941, at the age of 39, he was made a regional judge, the youngest ever appointed.

As the government's chief law officer, he was seldom out of the news. He prosecuted William Joyce, known as “Lord Haw-Haw”, for broadcasting for the Germans during the war; and Klaus Fuchs and Alan Nunn May, who gave atomic secrets to the Russians.

Attlee's government was defeated in 1951 by the Conservatives (under an ageing Churchill). Attlee himself resigned as party chief in 1955. Many in the party wanted Sir Hartley to replace him. But he was through with politics. He had enjoyed being attorney-general and holding various other top jobs, among them Britain's delegate to the United Nations during a particularly chilly time of the cold war. But “I found it utterly tedious to have to conform to the doctrine that it is the duty of the opposition to oppose.” One of his problems was that he admired some Conservative politicians, and even their policies. He was cautious about change. “The so-called new morality,” he said, “is often the old immorality condoned.”

In 1958 he resigned from the Commons. He was appointed to the Lords, the upper house, but did not speak there for 15 years out of a reluctance to clash with former colleagues. He had hopes of becoming Britain's senior judge, Lord Chief Justice, but the occupant of the post declined to budge. Instead, the might-have-been prime minister and head judge became simply a member of the great and the good. Lord Shawcross, as he now was, served on numerous worthy committees and on the boards of companies. Accepting a multitude of appointments, he said, kept him going. He noted that friends who had retired turned up shortly afterwards in obituary columns.

Lord Shawcross outlived two of his wives. In 1997, when he was 95, he proposed to Monique Huiskamp, whom he had known for many years. A court upheld objections by Lord Shawcross's relations to the marriage. The couple eloped to Gibraltar, where a court allowed the marriage. Lord Shawcross found it agreeable that he could still win a case.

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Overview

Jul 17th 2003
From The Economist print edition

Alan Greenspan reassured markets that the Fed would keep **American interest rates** low for "as long as it takes" to speed an economic recovery. His remarks caused ten-year American bond yields to jump to just under 4.0%. Producer prices and retail sales both rose by 0.5% in June.

America's visible-trade deficit widened by $46.8 billion in May. This increase came despite the recent weakness of the dollar.

In the **euro area**, **Germany** saw a sharp and unexpected rise in business sentiment in July. Thirty-year German government-bond yields rose to a three-month high.

French consumer-price inflation edged up to 2.0% in the year to June. Thanks to a series of strikes, and perhaps also to a strong euro, French industrial production fell by 1.4% in May, after a 0.8% decline in April. Industrial production was also down by 1.5% in the 12 months to May.

In **Italy**, industrial production fell by more than it did in France in the 12 months to May: it suffered a decline of 7.0%. Consumer prices in **Spain** rose by 2.7% in the 12 months to June.

Consumer-price inflation in **Britain** eased unexpectedly in June to 2.9%, helped in part by cheaper holidays. That is still, however, higher than the Bank of England's 2.5% target. The inflation figures came after the Bank had already cut interest rates by a quarter-point to 3.5%.

Sweden's industrial production fell by 1.1% in the 12 months to May. Consumer prices rose by 1.8% in the 12 months to June, slower than the 2.0% growth in the previous 12 months. The Swedish central bank cut interest rates by a quarter-point to 2.75%.

The Bank of Canada followed the Swedish model by cutting interest rates by a quarter-point, to 3.0%. The **Canadian economy** has been weak because of SARS, and also because of a sharp rise in the Canadian dollar against America's. Unemployment eased slightly to 7.7% in June.

Japanese industrial production grew by a revised 1.7% in the 12 months to May. Producer prices fell by 1.0% in the 12 months to June.

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Output, demand and jobs

Jul 17th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.9	Q1	+ 2.8	+ 2.8	+ 3.5	nil	Q1	+ 4.0	Q1	6.1	Jun	6.5
Austria	+ 1.3	Q4	– 0.5	+ 0.5	+ 1.3	– 1.5	Dec	– 3.1	Mar	4.4	Jun	4.3
Belgium	+ 1.3	Q1	+ 0.6	+ 0.8	+ 1.6	– 3.8	May	nil	Apr	11.6	Jun†	10.4
Britain	+ 2.1	Q1	+ 0.3	+ 1.8	+ 2.5	– 2.6	May	+ 3.1	May	5.0	May††	5.2
Canada	+ 2.6	Q1	+ 2.4	+ 2.3	+ 3.0	– 1.0	Apr	+ 1.4	Apr	7.7	Jun	7.5
Denmark	+ 1.2	Q1	+ 1.4	+ 1.0	+ 2.0	– 0.8	May	– 1.6	Apr	6.0	May	5.1
France	+ 1.1	Q1	+ 1.1	+ 0.8	+ 1.9	– 1.5	May	– 2.0	May	9.3	May	8.9
Germany	+ 0.2	Q1	– 0.9	nil	+ 1.2	+ 0.2	May	+ 0.8	May	10.6	Jun§	9.8
Italy	+ 0.8	Q1	– 0.4	+ 0.6	+ 1.6	– 7.0	May	+ 3.0	Apr‡	8.8	Apr	9.0
Japan	+ 2.6	Q1	+ 0.6	+ 0.8	+ 0.8	+ 1.7	May	– 2.3	May	5.4	May	5.4
Netherlands	+ 0.2	Q1	– 0.3	– 0.2	+ 1.3	– 3.7	May	– 0.6	Mar	5.5	Jun**	4.0
Spain	+ 2.1	Q1	+ 2.0	+ 1.9	+ 2.6	– 1.3	May	+ 2.7	Apr	11.3	May	11.2
Sweden	+ 2.2	Q1	+ 2.4	+ 1.4	+ 2.1	– 1.1	May	+ 2.7	May	4.2	May†	3.4
Switzerland	nil	Q1	– 1.0	+ 0.1	+ 1.4	+ 0.9	Q1	+ 0.4	Apr	3.6	Jun†‡	na
United States	+ 2.0	Q1	+ 1.4	+ 2.3	+ 3.4	– 0.8	May	+ 6.1	May	6.4	Jun	5.8
Euro area	+ 0.8	Q1	+ 0.1	+ 0.6	+ 1.7	+ 0.8	Apr	+ 2.2	Apr	8.8	May	8.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.2	Q1	– 4.9	na	na	– 1.5	May	+ 3.7	Mar	11.4	May†	11.9
Greece	+ 4.3	Q1	na	na	na	+ 4.1	May	na		na		na
Iceland	+ 3.3	Q1	na	na	na	– 0.3	2002	na		3.6	May†	2.5
Ireland	+ 6.4	Q4	na	na	na	+ 1.5	May	+ 3.2	Apr	4.7	Jun	4.4
Luxembourg	+ 1.1	2002	na	na	na	+ 1.1	Apr	+ 4.6	Jan	3.6	May	2.7
New Zealand	+ 3.6	Q1	+ 3.3	na	na	+ 5.9	Q4	+ 6.4	Q1	5.0	Q1	5.3
Norway	+ 0.6	Q1	+ 1.3	na	na	– 5.7	May	+ 3.5	May	4.4	Q1	4.1
Portugal	– 1.2	Q1	+ 0.3	na	na	– 2.6	May	+ 0.3	May	6.4	Q1†	4.5

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Mar-May; claimant count rate 3.1% in June. §EU harmonised rate 9.4% in June. **Apr-Jun.

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Prices and wages

Jul 17th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 3.4	Q1	+ 2.9	+ 2.9	+ 2.5	+ 3.0	Q1	+ 0.5	+ 4.3	Q1	+ 4.1
Austria	+ 1.1	Jun	+ 1.7	+ 1.4	+ 1.1	+ 1.7	Jun	– 1.7	+ 2.1	May	+ 2.4
Belgium	+ 1.6	Jun	+ 0.9	+ 1.3	+ 1.1	– 0.4	May	– 0.2	+ 1.7	Q2	+ 2.6
Britain	+ 2.9	Jun	+ 1.0	+ 2.8	+ 2.4	+ 1.1	Jun	– 0.1	+ 3.4	May	+ 3.8
Canada	+ 2.9	May	+ 1.0	+ 2.9	+ 2.0	– 1.7	May	– 2.2	+ 1.9	Apr	+ 2.8
Denmark	+ 2.2	Jun	+ 2.2	+ 2.3	+ 1.8	– 0.2	Jun	– 1.2	+ 3.9	Q1	+ 4.0
France	+ 2.0	Jun	+ 1.4	+ 1.8	+ 1.3	+ 0.7	May	– 1.2	+ 2.9	Q1	+ 4.0
Germany	+ 1.0	Jun	+ 1.0	+ 0.8	+ 0.5	– 0.2	May	– 1.3	+ 2.3	Apr	+ 2.4
Italy	+ 2.6	Jun	+ 2.2	+ 2.5	+ 1.8	+ 1.6	May	– 0.5	+ 1.7	May*	+ 2.3
Japan	– 0.2	May	– 0.9	– 0.4	– 0.5	– 1.0	Jun	– 2.1	+ 2.4	May	– 0.3
Netherlands	+ 2.2	Jun	+ 3.4	+ 2.4	+ 1.8	+ 2.5	May	– 1.9	+ 2.9	May	+ 3.6
Spain	+ 2.7	Jun	+ 3.4	+ 3.0	+ 2.5	+ 0.7	May	+ 0.5	+ 4.9	Q1	+ 4.0
Sweden	+ 1.8	Jun	+ 2.0	+ 2.1	+ 1.7	– 1.4	May	– 0.2	+ 2.3	Apr	+ 2.6
Switzerland	+ 0.5	Jun	+ 0.3	+ 0.7	+ 0.7	– 0.5	May	– 1.3	+ 1.8	2002	+ 2.5
United States	+ 2.1	May	+ 1.2	+ 2.2	+ 1.5	+ 2.9	Jun	– 2.3	+ 3.0	Jun	+ 2.8
Euro area	+ 2.0	Jun	+ 1.9	+ 1.8	+ 1.3	+ 1.3	May	– 0.8	+ 3.0	Q1	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.8	Jun	+ 1.1	na	na	– 1.0	Jun	– 1.8	+ 4.1	Q1	+ 3.2
Greece	+ 3.8	Jun	+ 3.3	na	na	+ 2.4	May	+ 1.3	na		na
Iceland	+ 1.6	Jul	+ 4.1	na	na	+ 3.2	Jul	+ 7.1	+ 5.6	May	+ 7.5
Ireland	+ 3.5	Jun	+ 4.4	na	na	–10.0	May	– 0.5	+ 7.1	Q1	+ 6.9
Luxembourg	+ 1.8	Jun	+ 1.7	na	na	+ 1.8	Apr	– 2.5	+ 3.1	Mar	– 1.2
New Zealand	+ 1.5	Q2	+ 2.8	na	na	– 1.3	Q1	+ 2.8	+ 2.3	Q1	+ 2.1
Norway	+ 1.7	Jun	+ 0.4	na	na	+ 2.8	Jun	–15.8	+ 5.3	Q1	+ 4.6
Portugal	+ 3.3	Jun	+ 3.4	na	na	+ 1.1	May	+ 0.6	+ 1.1	Apr	+ 0.1

*New series.

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Multilateral environmental agreements

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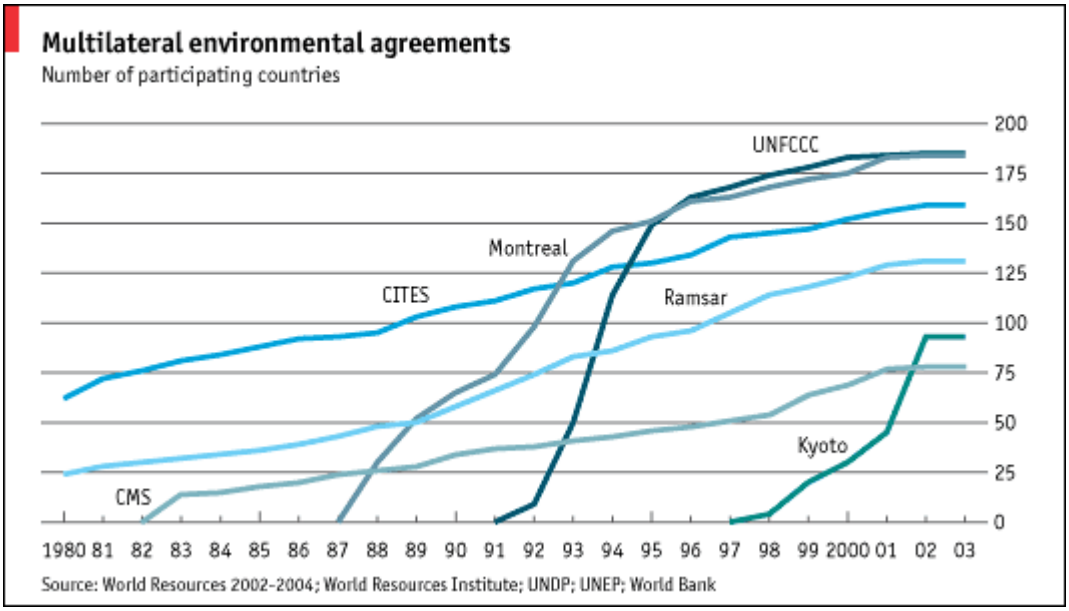
From The Economist print edition



Early environmental treaties dealt with single issues. The Ramsar Convention is about wetland conservation, CMS covers migratory species, CITES deals with trade in endangered species, and Montreal concerns ozone depletion. Later treaties are broad frameworks, as in UNFCCC, the UN convention on climate change, to which Kyoto is a protocol. Some are ratified faster than others; Kyoto needs Russian approval to come into force.

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Jul 16th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.7	+11.6	May	4.73	4.99	4.63	5.36	5.95	5.80
Britain	+ 7.9	+ 8.3	May	3.38	4.00	3.22	4.33	4.96	5.82
Canada	+10.3	+ 7.1	May	2.84	2.84	3.04	4.82	5.38	6.45
Denmark	+ 9.7	+12.2	May	2.25	3.66	2.25	4.15	5.08	5.40
Japan	+ 4.7	+ 1.8	Jun	0.01	0.03	0.07	1.03	1.26	1.11
Sweden	+ 4.0	+ 7.1	May	2.66	4.20	2.94	4.33	5.28	3.54
Switzerland	+27.6	+10.6	May	0.29	1.17	0.35	2.39	3.01	3.12
United States	+ 7.0	+ 7.1	Jun	1.00	1.74	1.46	3.94	4.66	5.76
Euro area†	+11.4	+ 8.5	May	2.13	3.41	2.27	3.93	4.82	3.97

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.9%, Japan No.251 1.04%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.5%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

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1995=100

	Jul 8th	Jul 15th*	% change on one month	% change on one year
Dollar index				
All items	76.4	76.1	– 1.1	+ 3.3
Food	76.4	74.9	– 3.2	– 1.5
Industrials				
All	76.5	77.6	+ 1.8	+10.4
Nfa†	79.8	79.5	– 0.8	+12.5
Metals	73.7	76.0	+ 4.2	+ 8.6
Sterling index				
All items	73.7	74.9	+ 4.2	+ 1.3
Euro index				
All items	88.9	89.0	+ 3.9	– 7.1
Yen index				
All items	96.2	95.0	– 1.8	+ 4.7
Gold				
$ per oz	344.30	344.50	– 5.2	+ 8.3
West Texas Intermediate				
$ per barrel	30.24	31.62	+ 1.8	+13.9

* Provisional. † Non-food agriculturals.

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Stockmarkets

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Market indices

	Jul 16th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,075.2	3,077.0	2673.3	+ 2.2	-10.6	+ 3.4	+20.6
Austria (ATX)	1,350.3	1,350.3	1120.2	+ 1.5	-22.3	+17.4	+25.5
Belgium (Bel 20)	1,971.6	2,074.1	1426.6	+ 0.3	-46.5	- 2.6	+ 4.1
Britain (FTSE 100)	4,077.1	4,207.0	3287.0	+ 0.6	-41.2	+ 3.5	+ 2.5
Canada (Toronto Composite)	7,082.0	7,121.0	6228.6	- 0.5	-37.8	+ 7.1	+21.8
Denmark (KBX)	186.4	188.8	145.0	+ 1.6	-38.2	+12.1	+19.7
France (SBF 250)	2,132.6	2,154.5	1630.1	+ 0.5	-51.4	+ 3.9	+11.0
(CAC 40)	3,150.7	3,213.9	2403.0	+ 0.3	-54.5	+ 2.8	+ 9.9
Germany (DAX)	3,387.6	3,396.1	2203.0	+ 2.0	-58.0	+17.1	+25.2
Italy (BCI)	1,170.8	1,195.9	959.4	+ 0.8	-46.3	+ 7.2	+14.6
Japan (Nikkei 225)	9,736.0	9,991.0	7607.9	- 2.6	-75.0	+13.5	+13.9
(Topix)	949.3	979.4	770.6	- 3.1	-67.1	+12.6	+13.0
Netherlands (AEX)	308.3	337.3	218.4	+ 1.9	-56.1	- 4.5	+ 2.1
Spain (Madrid SE)	729.7	739.5	576.8	+ 0.4	-36.3	+15.1	+23.0
Sweden (Affarsvarlden Gen)	161.6	162.5	127.8	+ 0.6	-59.6	+11.3	+18.7
Switzerland (Swiss Market)	4,940.1	4,992.5	3675.4	+ 1.5	-41.3	+ 6.7	+ 7.1
United States (DJIA)	9,094.6	9,323.0	7524.1	- 0.7	-22.4	+ 9.0	+ 9.0
(S&P 500)	994.1	1,011.7	800.7	- 0.8	-34.9	+13.0	+13.0
(NASDAQ Comp)	1,748.0	1,754.8	1271.5	nil	-65.4	+30.9	+30.9
Europe (FTSE Eurotop 300)*	866.7	890.8	682.7	+ 0.4	-49.2	+ 1.1	+ 8.1
Euro area (FTSE Ebloc 100)*	750.5	758.6	565.7	+ 0.7	-51.6	+ 4.5	+11.7
World (MSCI)†	886.4	907.3	710.8	- 0.9	-38.8	na	+11.9
World bond market (Citigroup)‡	552.5	583.9	518.6	- 1.0	- 5.4	na	+ 5.2

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

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	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Jul 16th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Jul 16th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 9.5	May	− 20.8	Q1	− 5.1	− 4.3	83.0	72.3	1.52	1.81	2.43	1.71	1.29	0.2
Austria	+ 1.0	Apr	+ 1.7	Apr	+ 0.1	nil	103.0§	100.4	0.89	0.99	1.42	–	0.75	-1.3
Belgium	+ 17.8	May	+ 10.7	Mar	+ 4.7	+ 4.7	103.3§	99.4	0.89	0.99	1.42	–	0.75	nil
Britain	− 73.7	May	− 5.8	Q1	− 1.4	− 1.4	98.7	104.8	0.63	0.64	–	0.70	0.53	-1.9
Canada	+ 36.2	May	+ 13.9	Q1	+ 1.8	+ 1.5	84.4	76.8	1.39	1.54	2.22	1.56	1.17	1.1
Denmark	+ 9.3	May	+ 5.5	May	+ 2.6	+ 2.3	106.3	103.5	6.63	7.38	10.6	7.44	5.61	1.6
France	+ 6.8	May	+ 25.3	Apr	+ 1.7	+ 1.6	106.8§	102.1	0.89	0.99	1.42	–	0.75	-3.6
Germany	+127.3	May	+ 49.7	May	+ 2.1	+ 1.9	104.4§	98.9	0.89	0.99	1.42	–	0.75	-3.7
Italy	+ 3.6	May	− 12.3	Apr	− 0.5	− 0.5	76.1§	72.8	0.89	0.99	1.42	–	0.75	-2.4
Japan	+ 96.9	May	+114.9	May	+ 2.2	+ 2.4	129.8	137.8	118	116	189	133	–	-7.7
Netherlands	+ 29.5	Apr	+ 2.9	Q1	+ 2.5	+ 2.7	102.8§	98.4	0.89	0.99	1.42	–	0.75	-1.6
Spain	− 44.4	Apr	− 19.0	Apr	− 2.3	− 2.3	77.3§	74.5	0.89	0.99	1.42	–	0.75	-0.4
Sweden	+ 15.7	May	+ 11.5	Q1	+ 3.5	+ 3.3	80.5	76.4	8.17	9.24	13.0	9.17	6.91	0.7
Switzerland	+ 5.5	May	+ 32.8	Q1	+11.6	+11.3	111.7	114.8	1.38	1.45	2.20	1.54	1.16	na
United States	−525.4	May	−510.2	Q1	− 5.3	− 5.5	104.5	111.0	–	–	1.60	1.12	0.85	-4.6
Euro area	+ 86.8	Apr	+ 44.1	Apr	+ 0.7	+ 0.6	89.6	82.6	0.89	0.99	1.42	–	0.75	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.8	May	+ 10.0	May	na	na	82.2§	78.5	0.89	0.99	1.42	–	0.75	3.1
Greece	− 23.0	Apr	− 11.0	Apr	na	na	59.7§	57.7	0.89	0.99	1.42	–	0.75	-1.0
Iceland	nil	May	nil	Q1	na	na	97.2**	86.2	77.6	83.8	124	87.0	65.6	nil
Ireland	+ 36.8	Apr	− 2.1	Q1	na	na	95.5§	88.1	0.89	0.99	1.42	–	0.75	-0.8
Luxembourg	− 3.2	Apr	+ 1.8	Q1	na	na	103.3§	99.4	0.89	0.99	1.42	–	0.75	0.2
New Zealand	− 1.1	May	− 1.4	Q1	na	na	99.8	86.4	1.71	2.08	2.73	1.92	1.45	0.8
Norway	+ 27.5	Jun	+ 25.7	Apr	na	na	96.0	105.7	7.45	7.34	11.9	8.36	6.30	11.3
Portugal	− 12.7	Apr	− 8.6	Apr	na	na	92.7**	89.9	0.89	0.99	1.42	–	0.75	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, May average. ‡OECD forecast. **IMF, March average.

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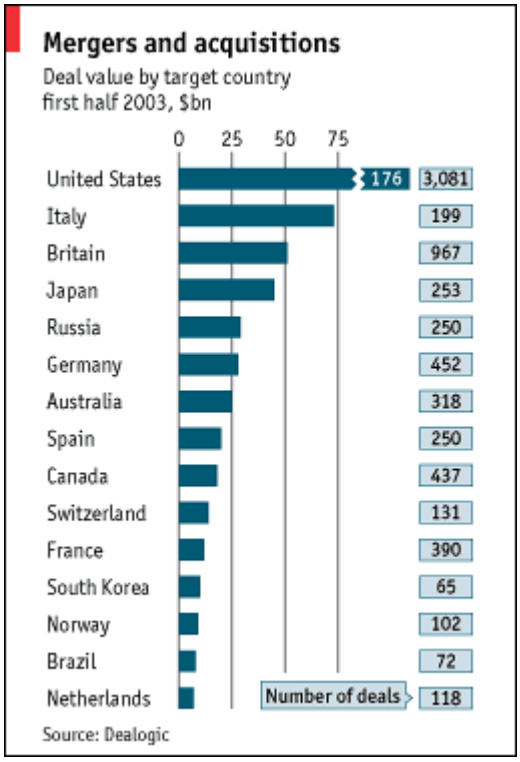
Mergers and acquisitions

Jul 17th 2003
From The Economist print edition



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Overview

Jul 17th 2003
From The Economist print edition

China's GDP growth fell to a 12-year low of 6.7% in the year to the second quarter, owing mostly to the effects of SARS.

Industrial production in **Mexico** fell by 2.3% in the 12 months to May, thanks in part to sluggish economic growth in America and increased competition from Chinese imports.

Russia's economy remains strong: industrial production rose by 7.0% in the 12 months to June. In the 12 months to May, **Hungary's** industrial production expanded by a revised 4.4%.

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Disasters

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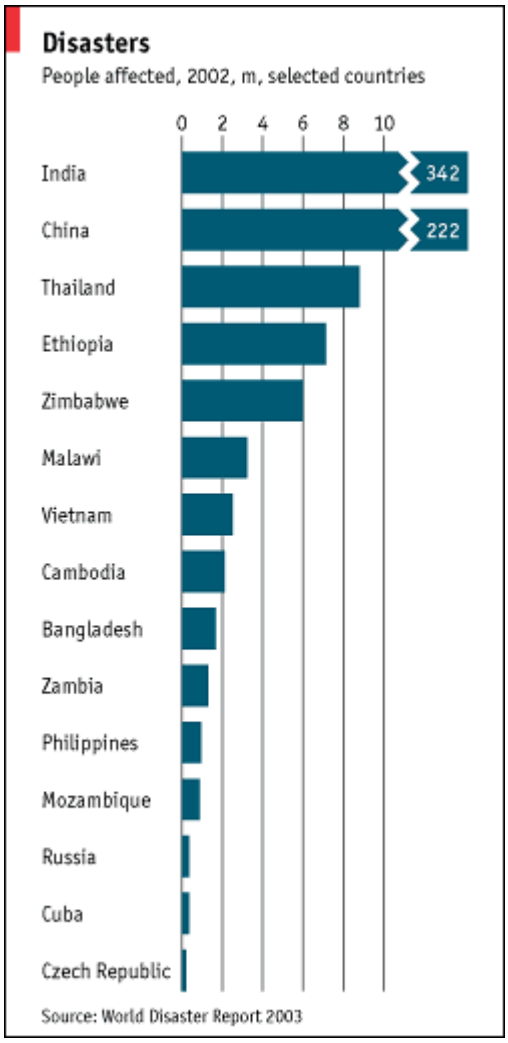
More than 608m people suffered from disasters last year, according to the International Federation of Red Cross and Red Crescent Societies. Drought took a toll in India and Africa, while China and Thailand were swept by floods. Weather-related disasters are on the increase: from 200 a year in 1993-97 to 331 a year in 1998-2002. The numbers of people needing food, shelter, medical aid and other assistance because of natural and industrial disasters more than tripled from 2001 to 2002.



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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 6.7	Q2	+16.9	Jun	+ 0.3	Jun	+21.5	Jun	+35.4	2002	331.1	Apr
Hong Kong	+ 4.5	Q1	– 8.8	Q1	– 2.5	May	– 7.6	May	+18.4	Q1	114.4	Jun
India	+ 4.9	Q1	+ 4.9	Apr	+ 4.7	May	–10.6	May	+ 4.8	Q4	78.2	Jun
Indonesia	+ 3.4	Q1	+18.4	Mar	+ 6.6	Jun	+25.3	May	+ 7.5	Q4	33.0	May
Malaysia	+ 4.0	Q1	+16.2	May	+ 0.8	Jun	+16.3	May	+ 8.5	Q1	35.4	May
Philippines	+ 4.5	Q1	+ 2.0	Apr	+ 3.4	Jun	– 0.1	Apr	+ 2.9	Mar	12.7	Jun
Singapore	– 4.3	Q2	– 9.5	May	– 0.1	May	+12.3	May	+21.3	Q1	86.6	Jun
South Korea	+ 3.7	Q1	– 1.9	May	+ 3.0	Jun	+ 8.8	Jun	+ 2.7	May	128.3	May
Taiwan	+ 3.2	Q1	– 2.8	May	– 0.4	Jun	+16.4	Jun	+25.9	Q1	176.7	Jun
Thailand	+ 6.7	Q1	+12.8	May	+ 1.7	Jun	+ 4.3	May	+ 8.3	May	38.3	Jun
Argentina	+ 5.1	Q1	+12.2	May	+10.2	Jun	+17.0	May	+10.1	Q1	12.2	Jun
Brazil	+ 2.0	Q1	– 0.3	May	+16.6	Jun	+20.9	Jun	– 0.6	May	43.4	May
Chile	+ 3.5	Q1	+ 4.0	May	+ 3.6	Jun	+ 2.4	May	– 0.6	Q1	15.9	May
Colombia	+ 3.8	Q1	– 3.3	Apr	+ 7.2	Jun	– 0.4	Feb	– 1.6	Q4	10.6	May
Mexico	+ 2.3	Q1	– 2.3	May	+ 4.3	Jun	– 6.6	May	–12.7	Q1	52.9	Jun
Peru	+ 1.8	May	– 0.5	Apr	+ 2.2	Jun	+ 0.5	May	– 1.1	Q1	9.4	Jun
Venezuela	–29.0	Q1	–14.6	Apr	+34.2	Jun	+15.0	Q1	+ 9.5	Q1	10.5	Apr
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.7	Apr	– 7.1	Mar	+ 1.0	Q1	13.4	Jun
Israel	+ 0.3	Q1	– 2.4	Apr	– 0.3	Jun	– 6.2	Jun	– 0.5	Q1	24.5	Jun
South Africa	+ 2.5	Q1	– 4.0	May	+ 7.8	May	+ 3.2	May	– 0.2	Q1	6.0	May
Turkey	+ 8.1	Q1	+ 4.8	May	+29.8	Jun	–14.0	May	– 3.3	Apr	28.6	May
Czech Republic	+ 2.2	Q1	+ 3.2	May	+ 0.3	Jun	– 2.3	May	– 4.4	Q1	25.6	Jun
Hungary	+ 2.7	Q1	+ 4.4	May	+ 4.3	Jun	– 3.1	May‡	– 3.7	May	12.4	Jun
Poland	+ 2.2	Q1	+11.7	May	+ 0.8	Jun	–10.2	May	– 5.6	May	32.3	May
Russia	+ 5.2	Q4	+ 7.0	Jun	+14.0	Jun	+52.6	May	+38.3	Q1	60.7	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 1.9	Jun	+ 1.1	Jun	+ 2.6	2002†	9.7	Apr
Saudi Arabia	+ 0.7	2002§	na		– 1.5	Apr	+38.6	2002§	+11.7	2002	23.1	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series. §Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Jul 17th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 16th		Dec 31st 2002	
	Jul 16th	year ago	Jul 16th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.2	na	1,602.0	+1.8	+ 12.9	+ 12.9
Hong Kong	7.80	7.80	12.4	1.16	10,207.2	+1.8	+ 9.5	+ 9.5
India	46.2	48.8	73.6	4.94	3,721.7	+2.8	+ 10.2	+ 14.5
Indonesia	8,234	8,965	13,136	9.64	524.3	+0.9	+ 23.4	+ 34.1
Malaysia	3.80	3.80	6.06	3.10	724.4	−0.2	+ 12.1	+ 12.1
Philippines	53.4	50.4	85.2	7.38	1,270.3	−1.9	+ 24.7	+ 24.6
Singapore	1.76	1.74	2.81	0.69	1,595.9	+4.8	+ 19.0	+ 17.3
South Korea	1,177	1,162	1,877	4.11	716.5	+1.6	+ 14.2	+ 15.1
Taiwan	34.4	32.8	54.8	1.05	5,413.9	+1.0	+ 21.6	+ 23.1
Thailand	41.7	40.5	66.4	1.26	503.2	+4.3	+ 41.2	+ 46.1
Argentina	2.77	3.50	4.42	10.00	698.3	−3.2	+ 33.0	+ 61.7
Brazil	2.86	2.89	4.57	25.75	13,478.7	−1.0	+ 19.6	+ 47.8
Chile	698	693	1,114	2.76	6,040.7	+0.0	+ 20.3	+ 24.1
Colombia	2,889	2,528	4,608	7.80	2,158.7	−2.0	+ 34.2	+ 33.2
Mexico	10.40	9.63	16.6	5.09	7,023.9	−2.1	+ 14.6	+ 15.3
Peru	3.47	3.54	5.54	3.41	1,829.0	−1.3	+ 31.4	+ 33.1
Venezuela	1,598	1,316	2,549	17.71	15,074.6	+3.5	+ 88.1	+ 63.2
Egypt	6.10	4.63	9.72	10.28	8,555.2	−5.3	+ 59.3	+ 21.0
Israel	4.44	4.66	7.08	4.58	432.5	−2.6	+ 30.1	+ 39.2
South Africa	7.8	10.1	12.4	11.55	8,756.0	+1.5	− 5.6	+ 4.4
Turkey	1,390,000	1,641,750	2,217,606	34.00	10,791.4	+4.1	+ 4.1	+ 24.3
Czech Republic	28.5	29.5	45.4	2.25	558.0	+2.8	+ 21.1	+ 28.0
Hungary	234	244	374	9.42	8,030.5	−0.6	+ 3.0	− 1.2
Poland	3.98	4.09	6.35	5.25	17,382.9	+2.9	+ 21.0	+ 16.6
Russia	30.5	31.6	48.7	16.00	448.7‡	−9.1	+ 19.3	+ 25.0
EMF (MSCI)*	1.00	1.00	1.60	na	350.4	+0.2	na	+ 19.9
EMBI+†	1.00	1.00	1.60	na	269.4	+0.7	na	+ 17.7

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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